NO. 93-166

IN THE
Supreme Court of the United States

October Term, 1992

Supreme Court, U.S.
FILED
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OFFICE OF THE CLERK

WALTER KILIMNIK and AEROSPACE & CORROSION INTERNATIONAL, INC., a Washington corporation,

Petitioners

v.

ZACHARY STOUMBOS, TRUSTEE, as successor to DALE W. WHITESIDES, TRUSTEE,

Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

Issue No. 1.

There is a split between the circuits on whether a security interest in the inventory of a retail/sales business automatically extends to after-acquired inventory, even without specifically saying so. Did the Court of Appeals for the Ninth Circuit err in failing to side with those circuits which follow the majority rule, holding that specific "hereafter acquired" language is not required?

Issue No. 2.

The Ninth Circuit considered extrinsic evidence to determine the intent of parties to a contract in resolving an issue of contract interpretation. Did the Ninth Circuit err in failing to remand the case to the trial court for factual findings on the parties' intent?

Issue No. 3.

The appellant sought to have petitioner-appellee Walter Kilimnik's claim subordinated to the claims of other creditors in bankruptcy. Instead of remanding the case to the bankruptcy court to make factual findings pertinent to the elements of equitable subordination, the Ninth Circuit used other findings from the bankruptcy court -- developed for issues other than equitable subordination -- and held that they supported equitable subordination as well. In doing so the Ninth Circuit created case law which directly contradicts a line of cases from the Court of Appeals for the Fifth Circuit which specifically prohibit an appellate court from using findings in this way. Did the Ninth Circuit err in "borrowing" irrelevant factual findings to support this remedy, rather than remanding the case to the bankruptcy court for further findings, thus creating a split among the circuits?

LIST OF ALL PARTIES

American Alloy Metals, Inc., Debtor

Zachary Stoumbos, Trustee (successor)

Dale W. Whitesides, Trustee (deceased)

Walter Kilimnik

Aerospace & Corrosion International, Inc., a Washington corporation (successor to AAM Aerospace & Corrosion International, Inc., a Washington corporation)

Aerospace & Corrosion International, Inc., a California corporation

Victory Metals, Inc. (successor to Aerospace & Corrosion International, Inc., a California corporation)

Cabot Corporation

Haynes International, Inc. (successor to Cabot Corporation)

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STATEMENT OF THE GROUNDS ON WHICH JURISDICTION IS INVOKED

Date of Order Denying Petition for Rehearing in the United States Court of Appeals for the Ninth Circuit:

4/30/93

Statute Conferring Jurisdiction to Review Order and Opinion:

28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS, STATUTES, AND REGULATIONS INVOLVED IN THE CASE

There are none directly at issue; the issues on appeal are all grounded in case law or Article 9 of the Uniform Commercial Code generally, adopted in the State of Washington as Chapter 62A.9 Wash. Rev. Code.

STATEMENT OF THE CASE

The essential facts are simple. Walter Kilimnik was the president and founder of a metal fabricating company. In 1982, he sold the assets of that company to another company, American Alloy Metals, Inc. ("AAM"), which he then joined as a president and shareholder. He retained a security interest in the assets and received a $3,950,000.00 promissory note (as well as other consideration) signed by AAM and its chief executive officer/general manager, Peter Suriano. Kilimnik became an officer and shareholder in AAM.

AAM and its chief executive officer, soon went into default on the note. When Kilimnik threatened to foreclose on his note in May, 1985, the chief executive officer left AAM. Kilimnik attempted to save the company, but was unsuccessful. In September, 1985, Kilimnik filed suit to enforce his security interests. AAM agreed to return the assets to Kilimnik, in exchange for Kilimnik foregoing the right to a deficiency judgment on the note. Kilimnik then transferred the assets to a new corporation he had recently created. AAM was placed in involuntary bankruptcy soon thereafter. The bankruptcy Trustee sued Kilimnik to recover assets he had received, arguing that Kilimnik did not have a perfected security interest in assets acquired by AAM after the 1982 sale. The Trustee also sought to have Kilimnik's claim in the bankruptcy subordinated to the claims of other creditors.

The Ninth Circuit dealt with many issues on appeal, but only two are directly relevant to this petition. The bankruptcy court had granted summary judgment in favor of Kilimnik, ruling that Kilimnik had a valid, perfected security interest in assets acquired after the 1982 sale.

The Ninth Circuit not only reversed that judgment, but made factual findings to the effect that Kilimnik did not have a perfected security interest in after-acquired assets. Part of the Ninth Circuit's findings concerning after-acquired equipment was based on extrinsic evidence of the intent of the parties to the 1982 purchase and sale agreement, but refused to consider the extrinsic evidence of intent concerning after-acquired inventory.

As the Ninth Circuit noted, there is a split between several circuits on what language is necessary in a contract to give a creditor a security interest in after-acquired inventory of a business which exists by selling and buying such inventory. Most circuits which have considered this issue hold that it is not necessary for the contract or security agreement to contain language specifically saying that the creditor has a security interest in inventory acquired by the

debtor after the sale, but that a security interest in "all inventory" (or language similarly broad) is sufficient to give such an interest unless the collateral is clearly restricted to pre-existing inventory.

The minority rule, which the Ninth Circuit sided with, is that even ambiguous language limiting collateral will defeat the automatic inclusion rule, and that language specifically reciting a security interest in after-acquired inventory is needed. The Ninth Circuit attempted to dodge this issue by construing ambiguous, at best, contractual language to find that the parties to the 1982 agreement had not intended to give Kilimnik a security interest in after-acquired inventory, ignoring extrinsic evidence directly to the contrary. Had the Ninth Circuit not discounted the evidence and properly construed the agreement, the Ninth Circuit would have more directly confronted the split between the circuits concerning automatic coverage of after-acquired inventory.

In addition, based on various findings of fact entered at the conclusion of trial, the Ninth Circuit decided to grant part of the relief which the bankruptcy court had denied, and directed the bankruptcy court to equitably subordinate Walter Kilimnik's claim to those of other creditors. However, the bankruptcy court never made any factual findings on the elements of equitable subordination.

BASIS FOR FEDERAL JURISDICTION

Bankruptcy Court:

28 U.S.C. § 157; General Rule 7 of the Rules of the United States District Court for the Western District of Washington.

District Court:

28 U.S.C. § 158(a); 28 U.S.C. § 1334.

Court of Appeals:

28 U.S.C. § 158(d); 28 U.S.C. § 1291.

ARGUMENT

A. The Ninth Circuit Perpetuated A Split Between The Circuits Concerning The Contract Language Necessary To Give A Creditor A Security Interest In Inventory Acquired By A Debtor In The Business Of Selling Such Inventories After Credit Has Been Extended.

This case involves a business which lived and died by its ability to purchase and sell specialty alloy metals used in aerospace and corrosion-resistance industries. The inventories had to be turned over in order for the business to survive. Under these circumstances most circuits and states hold that a security interest in inventory and accounts receivable automatically includes after-acquired inventory and accounts receivable as well. As the Ninth Circuit noted,

> There is substantial support for the proposition that, where a financing statement or a security agreement provides for a security interest in "all inventory" (or uses similar broad language), the document incorporates after-acquired inventory. The rationale is that inventory is constantly turning over, and no creditor could reasonably agree to be secured by an asset that would vanish in a short time in the normal course of business.

Opinion at 2145 (Appendix ("App.") No. 9, p. A-68), *Stoumbos v. Kilimnik (In re American Alloy Metals, Inc.)*, Nos. 91-35524, 91-35525 (9th Cir., March 9, 1993) (published as *Stoumbos v. Kilimnik*, 988 F.2d 949 (9th Cir. 1993)) (hereafter cited as

"*Opinion*"). The Ninth Circuit recognized that the majority rule was supported by cases from the D.C. Circuit, Fifth Circuit, Eighth Circuit, and various district and bankruptcy courts, some applying state law. The court also recognized contrary authority that claimed

> "the [UCC] contemplates that a security agreement should clearly spell out any claims to after-acquired collateral." *Covey v. First Nat'l Bank (In re: Balcain Equipment Company, Inc.)*, 80 B.R. 461, 462 (Bankr. C.D. Ill. 1987); *See, also, In re Middle Atl. Stud Welding Co.*, 503 F.2d 1133, 1135 (3rd Cir. 1974).

Id. The Ninth Circuit, however, concluded that it did not need to decide which view to adopt, and specifically claimed not to adopt the "majority" view:

> the Purchase Agreement does not contain the usual language granting a security interest in 'all inventory' or 'inventory' but only in the items specifically described in paragraph 1 as 'inventory. . . on hand at May 1, 1992.'

Opinion at 2147 (App. p. A-70). In doing so, the Ninth Circuit strictly construed one portion of the Agreement for Sale of Assets, Appendix No. 12, to exclude automatic coverage of after-acquired collateral, in line with those cases that refuse to recognize or apply the majority rule. The Ninth Circuit is in conflict with those circuits and cases which apply the automatic-coverage rule regardless of ambiguous language to the contrary in the purchase or security agreement, and also misconstrued the Agreement for Sale of Assets in this case.

1. **The Ninth Circuit is in conflict with cases which apply automatic coverage of after-acquired inventory, in spite of ambiguous limiting language in the instruments in question.**

The majority rule is that after-acquired inventory, of a retail or sales company, is automatically included in a secured creditor's collateral, regardless of the absence of language specifying that inclusion. While the Ninth Circuit focussed on broad security language such as "all inventory," other circuits focus more on whether the inventory and equipment are a part of the business's stock in trade. As stated in *In re McBee*,

> The vast majority of jurisdictions hold that when a security interest is taken in the inventory of a business, after-acquired inventory is automatically covered unless it is clearly set out that only certain items of inventory are to be covered. (citation omitted)
>
> As the Court in *In re Page*, 16 UCC Rep. 501, 504 (Bankr. M.D. Fla. 1974) stated:
>
> > Needless to say, any reasonably secured party would be fully aware that this type of business presupposes a constant change in the inventory. Therefore, it is obviously unreasonable to assume that anyone would have received or acquired or intended to acquire a security interest in an inventory with the rigid limitation that it should be limited to the same items which made up the inventory on the date the document was executed.
>
> This approach is consistent with the general liberal philosophy of the UCC and is certainly the prevailing and accepted commercial practice in financing retail merchandizing businesses.

714 F.2 1316, 1330 - 1331 (5th Cir. 1983), quoting *Get It Kwik of America v. First Alabama Bank*, 361 So.2d 568, 573-574 (Ala. App. 1978). The Fifth Circuit, applying Texas law, applied the automatic after-acquired inventory rule to any interest in inventory. *Id.*, 714

F.2d at 1331. *See, also, In re Fibre Glass Boat Corp.*, 324 F. Supp. 1054, 1056 (S.D. Fla.), *aff'd.*, 448 F.2d 781 (5th Cir. 1971).

Most courts apply the rule of automatic inclusion of after-acquired inventory in spite of language in the security agreement or sale agreement which could be construed to limit the inventory to that purchased or on-hand at the time credit is extended. *In re Sims Office Supply, Inc.*, 83 B.R. 69 (Bankr. M.D. Fla. 1988) ("all inventory sold to the [plaintiff] by the [defendant] in accordance with the Purchase Agreement"); *In re American Family and Marketing Corp.*, 92 B.R. 952, 953 (Bankr. M.D. Fla. 1988) (security interest only to "65% of the value of the inventory noted in Exhibit "A" attached to the Security Agreement"); *In re Page, supra* ("all inventory and equipment located at 8002 N. Amelia Avenue, Tampa, Florida, which was in its possession, custody and control at the time of the execution of the mortgage"); *Get it Kwik of America v. First Alabama Bank, supra*, 361 So.2d at 573 ("all inventory and fixtures now owned by Short Stop Stores, Inc., presently located at #3, Hwy. 20, Madison, Alabama").

The Ninth Circuit over-emphasized language in the Agreement for Sale of Assets describing the sale of "inventory . . . on hand at May 1, 1982" as excluding after-acquired collateral. By doing so, it sided with the minority decisions which limited collateral to pre-existing inventory based on similar language in spite of the fact that those debtors clearly depended on the sale and turn-over of inventory to conduct their businesses. *Covey v. First National Bank, supra; In re Sims Office Supply, Inc.*, 102 B.R. 259 (Bankr. M.D. Fla. 1989) (reaching the exact opposite conclusion on the same facts in the same case as the prior opinion at 83 B.R. 69, without reference to the prior opinion).

The confusion and differences among the circuits and federal courts, especially within the bankruptcy court for the Middle District of Florida, is evident. The Ninth Circuit's opinion in this case adds to this confusion. The better-reasoned rule is that adopted by the

majority of circuits and courts: Unless it is clear from the language of the security agreement or extrinsic circumstances, a security interest in inventory or accounts receivable automatically includes after-acquired inventory and accounts receivable where those assets are the company's stock in trade. As noted by the Fifth, Eighth and D.C. Circuits, it is simply commercially unreasonable to expect the parties to intend the security interest and collateral to vanish in a short period of time as those inventories and accounts receivable are consumed during the ordinary course of business.

Automatically including after-acquired collateral, unless expressly excluded, makes far more sense and is far more consistent with the philosophy of the Uniform Commercial Code to conform, where practicable, its standards to the prevailing and accepted commercial practices of retail businesses.

At worst, the failure to include an express after-acquired collateral clause in the security agreement in this case should merely have raised a question of fact to be resolved by the trier of fact, not the Court of Appeals, after consideration of all extrinsic evidence, per *In re Sims Office Supply, supra,* 83 B.R. at 74. The Ninth Circuit neither accepted the majority rule nor remanded the case for a trial on the merits. Granting the Writ of Certiorari to resolve the difference among the circuits, and the Ninth Circuit's fact-finding errors, is more than appropriate. SCR 10.1.(a).

2. The Ninth Circuit failed to properly construe the contract and security documents involved in this case.

The Ninth Circuit's finding, that only inventory sold was intended to be included within the security interest, was predicated on language in paragraph 25 of the Agreement for Sale of Assets:

> 25. UCC-1 For Sale. Buyer agrees to execute Form UCC-1 and to initial such additional sheets as

> may be required to describe the items of personal property being purchased hereunder.

App. 12, p. 105. The Ninth Circuit reasoned that the reference to "the items . . . purchased", described in paragraph 1, limited the collateral. Paragraph 1 states, in pertinent part,

> Buyer agrees to purchase from Seller . . . the following described personal property:
>
> (1) All inventories of metals and supplies, including back orders of such items, owned by seller at May 1, 1982. The listing of the inventory of metals on hand at May 1, 1982, and its assigned value is attached as Exhibit "A". . . .

Id. at A-96. As a description of items sold, paragraph 1 was accurate, but it was incorrect to bootstrap this description into a limitation on the Seller's security interest. The UCC-1 Financing Statement (App. 13) specifically provided for in paragraph 25, expressly included after-acquired assets:

> This financing statement covers the following types or items of property: All inventory, receivables, equipment, and all proceeds from the sale thereof, as well as all after-acquired inventory, receivables and equipment purchased from April 30, 1982.

App. p. A-107. In addition, paragraph 8 of the Agreement for Sale of Assets, "Security Agreement and Collateral," though failing to specifically mention inventory, did state,

> Buyer and Seller agree to the terms of the Working Capital Financial Agreement, attached hereto and made a part hereof, designated as Exhibit "H".

App. 12, p. A-100. The Working Capital Financial Agreement itself incorporated by reference (App. 14, p. A-110) another express security agreement, the Security Agreement, which gave Kilimnik a security interest in "(i)n all of debtor's inventory, including raw materials, work in process, and material used or consumed in Debtor's business, either now or hereafter acquired." App. 15, p. A-113.

The Ninth Circuit recognized this agreement but interpreted it to be limited solely "to the extent it secured working capital advanced by Kilimnik and outstanding at the time of foreclosure." *Opinion* at 2144 (App. 9, p. A-68).

On the contrary, if the Security Agreement's terms and language was only designed to secure and refer to the Working Financial Capital Agreement, there would have been no purpose in incorporating it by reference in paragraph 8 of the Agreement for Sale of Assets. That paragraph was designed to state the security interests and collateral pertaining to the financing of the purchase by the Buyer. Since the Security Agreement already secured any sums lent under the Working Capital Financial Agreement, limiting its application only to the additional financing essentially renders the incorporation of those terms into the Agreement for Sale of Assets meaningless and superfluous.

On the contrary, the Ninth Circuit should have interpreted the Agreement to give meaning and effect to all clauses within the contract, if possible, and avoided rendering any such language superfluous. *Fireman's Fund Insurance Co. v. Murchison*, 937 F.2d 204, 207 (5th Cir. 1991); *Garza v. Marine Transport Lines, Inc.*, 861 F.2d 23, 27 (2nd Cir. 1988); *Fortec Constructors v. United States*, 760 F.2d 1288, 1292 (Fed. Cir. 1985).

At most, the Ninth Circuit should have concluded the Agreement for Sale of Assets and its security clauses were ambiguous and remanded the case to the bankruptcy court for further

findings of fact in that regard. *See,* Section B, below. Had the Ninth Circuit done so, the result would have been obvious.

In addition to the clear and unmistakable language of the UCC-1 and Security Agreement, all of the extrinsic evidence and testimony from the two principals concerned, the Seller, Walter Kilimnik, and the Buyer, Peter Suriano, indicated that they intended after-acquired inventory, accounts receivable, and the proceeds of those assets to be included. *See,* Appendices 16 and 17, affidavits of Walter Kilimnik and Peter Suriano, respectively. In failing to do so, the Ninth Circuit took it upon itself to make incorrect conclusions of law concerning the ambiguous language of the contract or inappropriate findings of fact, in the face of clear and normally unquestioned precedent from other circuits.

B. The Ninth Circuit Made Factual Findings Concerning Intent, When It Should Have Remanded Those Factual Issues To The Trier Of Fact.

The second issue before this Court arose when the Ninth Circuit exceeded its appellate jurisdiction, considered extrinsic evidence on the intent of the parties to the 1982 agreement, and made factual findings concerning that intent. In exceeding its jurisdiction, the Ninth Circuit avoided an opportunity to help resolve a conflict between the circuits concerning the first issue, as argued above. The Supreme Court should review this issue because it relates to the conflict among the circuits on the issue above, and also because the Ninth Circuit's published opinion in this case creates a precedent for departing from the accepted and usual course of judicial proceedings on appeal. SCR 10.1.(a).

On May 20, 1987, the bankruptcy court entered an order on cross motions for partial summary judgment. Both motions raised the issue of whether Walter Kilimnik's foreclosure of his security interest was proper, and in turn, the issue of whether Walter Kilimnik had a perfected security interest in after-acquired assets.

The bankruptcy court's decision and reasoning are contained in the Memorandum Decision on Cross Motions for Partial Summary Judgment and Motion for Preliminary Injunction. Appendix No. 1. According to the Memorandum Decision,

> the purchase and sale agreement, when read as a whole, contains a security agreement that described adequately the collateral that is the subject of this dispute.

Id., p. 7 (p. A-10). The Ninth Circuit disagreed. Despite the fact that Kilimnik's financing statement specifically mentions after-acquired assets and incorporates by reference another security agreement which clearly covered after-acquired assets, the Ninth Circuit went beyond the four corners of the contract and reviewed extrinsic evidence to reach the opposite conclusion:

> We are aware that the financing statement mentions after-acquired equipment, suggesting that the parties intended Kilimnik's security interest would extend this far. Yet we must look to the entire circumstances under which the purchase agreement was made to ascertain its meaning. *See, Berg fv. Hudesman,* 111 Wn.2d 657, 801 P.2d 222, 229 (1990)]. Under Washington law, a contract is interpreted by reference to many contextual factors, including the subject matter of the transaction, the subsequent conduct of the parties and the reasonableness of their interpretations. *See, id.*
>
> The trustee here advances the more reasonable interpretation: Kilimnik took a kind of "purchase money" interest in the equipment he sold to AAM, but he did not get the additional security of a blanket interest in all equipment the company ever acquired after the sale. The subject matter of the transaction also supports this conclusion.

> Kilimnik would not have had a clear reason to want after-acquired equipment covered by the purchase agreement. As we have seen, equipment, unlike inventory, is not normally subject to frequent turnover. Even if limited to the equipment on hand at the time of the sale, his interest would have been secure.

Opinion at pps. 2147-8 (App. 9, p. A-71).

In short, the Ninth Circuit looked at extrinsic evidence, and not only failed to remand the issue to the bankruptcy court for findings of fact, but went ahead and made factual findings of its own. This contradicts every principle of appellate procedure governing review of summary judgment orders.

A court of appeals reviews a grant of summary judgment de novo, and "must determine whether, viewing the evidence in the light most favorable to the non-moving party, there are any genuine issues of material fact and whether the district court correctly applied the relevant substantive law." *Briggs v. Sullivan*, 954 F.2d 534, 537 (9th Cir. 1992); *Saul v. United States*, 928 F.2d 829, 832 (9th Cir. 1991). If a court of appeals reverses a lower court's grant of summary judgment, the case is remanded for trial. *Lowe v. City of Monrovia*, 775 F.2d 998, 1010 (9th Cir. 1985).

Normally, reversing a grant of summary judgment does not end a case, but merely revives it for trial or other final disposition. However, in limited situations, it is possible for an appellate court to not only reverse a grant of summary judgment to the appellee, but to go a step farther and grant summary judgment to the appellant, thus providing a final disposition of the case. This may be done where both sides brought cross motions for summary judgment and there is no genuine issue of fact. *Jonathan's Landing, Inc. v. Townsend*, 960 F.2d 1538, 1545 (11th Cir. 1992). "However, if. . it appears that the party opposing summary judgment on appeal had

no single 'fair opportunity to dispute the facts material to the new theory,' remand is appropriate." *Id. See, also, Sacred Heart Medical Center v. Sullivan*, 958 F.2d 537, 543 (3rd Cir. 1992); *Potenze v. New York Shipping Association, Inc.*, 804 F.2d 235, 239 (2nd Cir. 1986) (the appellate court must not grant summary judgment unless "*the opponent has had a full and fair opportunity to litigate the question* and no new facts would be developed on remand." (emphasis added)).

In other words, an appellate court can grant summary judgment for the appellee only if:

(1) There are no issues of fact;

(2) The appellee had a fair opportunity to dispute the facts material to the new theory; and

(3) No new facts can be developed on remand.

The Ninth Circuit interpreted a contract in this case. Contract interpretation is sometimes reviewed de novo, and sometimes reviewed as a question of fact:

> We review a district court's interpretation of a contract de novo if the district court did not go beyond the four corners of the document . . . if the court drew upon extrinsic evidence in interpreting a contract, we will not reverse a court's factual findings as to the extrinsic evidence unless clearly erroneous.

In re Agricultural Research and Technology Group, 916 F.2d 528, 538 (9th Cir. 1990). *See, also, L.K. Comstock & Company v. United Engineers & Constructors Inc.*, 880 F.2d 219, 221 (9th Cir. 1989) ("if 'the district court relies upon extrinsic evidence to interpret an ambiguous contract, that interpretation is a factual determination . . . .'"); *Kern Oil & Refining Company v. Tenneco*

Oil Company, 840 F.2d 730, 736 (9th Cir. 1988); *In re Cement and Concrete Antitrust Litigation*, 817 F.2d 1435, 1443 (9th Cir. 1987) ("We review de novo the interpretation of contract language but defer to the district court's findings of fact with respect to extrinsic evidence necessary to interpret a contract."). In particular, when a court "resorts to extrinsic evidence in order to determine the intent behind an ambiguous provision, [the appellate court will] defer to the court's interpretation unless it is clearly erroneous." *Forest Oil Corporation v. Strata Energy, Inc.*, 929 F.2d 1039, 1043 (5th Cir. 1991).

A factual finding will be reversed only if, after reviewing all the evidence, the court is left with "the definite and firm conviction that a mistake has been committed." *Cofield v. Alabama Public Service Commission*, 936 F.2d 512, 516 (11th Cir. 1991).

The Ninth Circuit relied on *Berg v. Hudesman*, 111 Wn.2d 657, 801 P.2d 222 (1990), for the proposition that it could consider extrinsic evidence of the circumstances surrounding the execution of the Agreement for Sale of Assets in connection with its interpretation of that agreement. However, *Berg* does not make an issue of law out of such evidence, for in *Berg* the Washington State Supreme Court specifically adopted the Restatement (2nd) of Contracts, § 212, which provides:

> (2) *a question of interpretation of an integrated agreement is to be determined by the trier of fact if it depends on the credibility of extrinsic evidence or on a choice among reasonable inferences to be drawn from extrinsic evidence.* Otherwise a question of interpretation of an integrated agreement is to be determined as a question of law.

Id. at 229 (emphasis added).

In interpreting the Agreement for Sale of Assets the Ninth Circuit considered extrinsic evidence of the circumstances surrounding that agreement, including the subject matter of the transaction, the subsequent conduct of the parties, and the reasonableness of their interpretations. *See, Opinion* at 2147 (App. 9, p. A-70,72). The Ninth Circuit concluded that the subject matter of the transaction gave rise to an inference that the parties did not intend to create a security interest in after-acquired inventory and equipment. *Id.*

However, when viewed in the light most favorable to Kilimnik, the party opposing summary judgment to the Trustee, this extrinsic evidence clearly gives rise to competing inferences as to the extent of Kilimnik's security interest. These competing inferences create a factual question which must be remanded to the bankruptcy court as the trier of fact.

Much of the extrinsic evidence supports the inference that the parties intended to grant Kilimnik a security interest in after-acquired inventory and equipment. One of the major items of extrinsic evidence supporting this inference is the fact that the parties executed a financing statement several months after the execution of the Agreement for Sale of Assets which specifically referred to after-acquired equipment and inventory. The parties' subsequent conduct in executing the financing statement extending to after-acquired inventory and equipment is a strong indication of their original intent to create a security interest extending to these after-acquired assets. *See, Berg v. Hudesman, supra,* 801 P.2d at 229. Indeed, in its ruling, the Ninth Circuit specifically recognized that the fact that the financing statement mentioned after-acquired assets suggested that Kilimnik's security interest was intended to encompass these assets. *See, Opinion* at 2147 (App. 9, p. A-70).

The affidavits of the parties to the contract are additional extrinsic evidence of the parties' intent to create a security interest in after-acquired inventory and equipment. Both parties stated that

they intended to create a security interest in all the assets described in the financing statement, including after-acquired inventory and equipment. *See*, affidavits of Walter Kilimnik, ¶ 12 (App. 16, p. A-120) and Peter Suriano, ¶ 9 (App. 17, p. A-128).

The Ninth Circuit exceeded its appellate jurisdiction by looking at extrinsic evidence to determine the intent of parties to a contract, and making factual findings concerning that intent. The Ninth Circuit should have remanded the case back to the bankruptcy court so that both parties would have a fair opportunity to dispute the material facts, and to develop new facts as necessary. Because the issue of whether Kilimnik had a security interest in after-acquired assets was decided on summary judgment, the parties never had an opportunity to present evidence at trial concerning their intent on that issue. The Ninth Circuit erred in denying them the opportunity to do so.

C. This Court Cannot Infer Elements Of Equitable Subordination From The Bankruptcy Court's Findings Of Fact.

The Ninth and the Fifth Circuits are split on whether an appellate court can take factual findings made by a bankruptcy court on other legal issues, and use them to support the elements of equitable subordination, thus ordering that a creditor's claim be subordinated, rather than remanding for factual findings on the elements of that remedy. The Fifth Circuit says no. The Ninth Circuit did so anyway, creating precedent that conflicts with Fifth Circuit case law. This is an appropriate issue for review on certiorari. SCR 10.1.(a).

It is well settled that three criteria must be satisfied in order for a creditor's claim to be equitably subordinated:

> (1) the creditor must have engaged in some type of inequitable conduct;

> (2) the misconduct must have resulted in injury to creditors of the bankrupt or conferred an unfair advantage on the claimant;
>
> (3) equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy Code.

Matter of Mobile Steel Company, 563 F.2d 692, 700 (5th Cir. 1977).

The Fifth Circuit has repeatedly held that a creditor's claim will not be equitably subordinated in the absence of explicit findings of fact and conclusions of law by the bankruptcy court on each of the three elements. *In re Missionary Baptist Foundation of America, Inc.*, 712 F.2d 206, 212 (5th Cir. 1983). Indeed, in *In re Fabricators, Inc.*, 926 F.2d 1458 (5th Cir. 1991), a case on which the Ninth Circuit heavily relied, the Fifth Circuit stated:

> In order to justify equitable subordination, the bankruptcy court is required to make specific findings and conclusions with respect to each of the [three] requirements.

926 F.2d at 1465.

In *In re Missionary Baptist Foundation of America, Inc.*, 712 F.2d 206 (5th Cir. 1983), the Fifth Circuit was confronted with a bankruptcy court that failed to make specific findings of fact on each of the three elements of equitable subordination. On appeal, the United States District Court for the Northern District of Texas concluded that sufficient findings were inherent in, or could be inferred from, the bankruptcy court's actual findings, and upheld the ruling on equitable subordination.

The Fifth Circuit reversed, concluding that, although the required elements for equitable subordination might be inherent in the bankruptcy court's ruling, a claim of equitable subordination could not be upheld in the absence of explicit factual findings on each of the three elements:

> These findings, though perhaps inherent in the bankruptcy court's ruling, were not enunciated. Though we agree that [the creditor's] insider connection with the debtor compels close examination of his claim, we cannot conclude, in the absence of explicit findings by the bankruptcy court on each element of the [equitable subordination] test that the Trustee has discharged his burden of proof thereunder.

In re Missionary Baptist Foundation of America, Inc., 712 F.2d at 212. The Fifth Circuit remanded the equitable subordination issue to the bankruptcy court. *Id.* at 213.

In the present case, the bankruptcy court did not make explicit findings of fact and conclusions of law with respect to the three elements of equitable subordination. Indeed, the bankruptcy court entered findings of fact consistent with its ruling that there was not sufficient evidence to justify equitable subordination of Kilimnik's claim. Specifically, the bankruptcy court found that Kilimnik did not improperly take the debtor's intangibles (App. 3, p. A-22); that he took steps with creditors to reduce certain inventories (*id.*, p. A-24; App. 4, p. A-37); that current liabilities were reduced while he was in control of the debtor (*id.* at A-37); and that creditors were paid substantial sums of money in the four months immediately preceding debtor's bankruptcy (*id.*, p. A-34).

The bankruptcy court orally ruled that Kilimnik's claim should not be subordinated:

> On this record, it would appear to me that where a secured creditor properly foreclosed a security agreement, that no duty to other creditors and/or to the corporation to continue it in existence as a going business remained. Even if there was a technical breach by Mr. Kilimnik in that he controlled both American Alloy Metals and ACI [Aerospace], or that he intended to set up ACI after the foreclosure, there was no damage to the creditors as a whole.
>
> Certainly there was benefit, on this record, to Mr. Kilimnik by his actions, in that he had the benefit of essentially putting in ACI as a going corporation; but I find no corresponding detriment or injury to the creditors as a whole.

Ruling of the Honorable Frank D. Howard, pps. 9,10 (App. 3, pps. A-24,25). The bankruptcy court did not revisit this issue in the written conclusions of law.

The Ninth Circuit nonetheless held that the elements of equitable subordination were "suggested by" or inherent in, the bankruptcy court's findings. *See, Opinion* at 2155 (App. 9, p. A-79).

The Ninth Circuit made the following factual findings in its written opinion:

> Here, the bankruptcy court's own findings suggest Kilimnik's actions could not withstand this rigorous scrutiny. As a secured creditor whose loan was in default, Kilimnik was entitled to foreclose, but, as president, controlling shareholder and director, he participated in the vote by AAM's board to waive its rights in the collateral. Admittedly AAM was thereby released from liability for the amount by

> which Kilimnik's claim exceeded the value of the collateral, but that does not cure the problem. . . .
>
> In addition, Kilimnik's other actions in the months preceding foreclosure demonstrate that he placed his own interests before those of AAM, and acted to the detriment of other creditors.

Id. The Ninth Circuit went on to discuss whether Kilimnik operated AAM in such a way as to prepare for his new corporation to take over the AAM business, whether he purposely increased inventories or built up trade debt before he foreclosed, whether he made assurances to suppliers to persuade them to continue doing business, and so forth.

However, as this Court can see by reviewing the bankruptcy court's memorandum decision (App. 1), the bankruptcy court did not make any findings concerning the elements of equitable subordination. To grant the remedy of equitable subordination, the bankruptcy court must make factual findings on whether Kilimnik's actions "resulted in injury to creditors," "conferred an unfair advantage on the claimant," and whether the creditor's conduct was "inequitable." *See, Matter of Mobile Steel Company, supra.* The bankruptcy court specifically found that creditors were not injured, and that, under the circumstances, Kilimnik's actions were proper and justified. The Ninth Circuit lacks jurisdiction to make new findings, but can only review the bankruptcy court's findings for clear error.

The Ninth Circuit should have remanded the case to the bankruptcy court with instructions to make factual findings under each of the elements of equitable subordination. The Ninth Circuit has now created precedent which conflicts with case law in the Fifth Circuit which denies appellate courts the jurisdiction to do this.

CONCLUSION

This case should be reviewed on a writ of certiorari for the following reasons:

1. The Ninth Circuit has exacerbated a conflict among the circuits concerning the contract language necessary to give a creditor an automatic security interest in inventory that a debtor in the business of selling inventory acquires after credit has been extended.

2. The Ninth Circuit exceeded its appellate jurisdiction by making factual findings concerning the intent of the parties to the 1982 Agreement for Sale of Assets.

3. The Ninth Circuit created a split between the Ninth and Fifth Circuit Courts of Appeals concerning an appellate court's jurisdiction to use findings of fact entered for one cause of action in support of granting positive relief under a completely different cause of action. If this holding is allowed to stand, it creates a dangerous precedent for appellate courts which wish to conduct a trial without involving the trial court, merely by adapting findings of fact to the elements of causes of action the trial court never considered in reviewing the evidence.

RESPECTFULLY SUBMITTED this 29th day of July, 1993.

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APPENDIX 1

United States Bankruptcy Court
Western District of Washington at Tacoma

In re American Alloy Metals, Inc., No. 85-02660; *Dale V. Whitesides v. Walter Kilimnik; AAM Aerospace & Corrosion International, et al. v. Cabot Corporation*, Adv. No. A86-30806.

Memorandum Decision on Cross Motions for Partial Summary Judgment and Motion for Preliminary Injunction

May 20, 1987

On May 28, 1986, this court heard arguments on the trustee's motion for partial summary judgment and preliminary injunction, and the defendants' cross-motion for partial summary judgment. William S. Weinstein appeared on behalf of the defendants. Joseph E. Shickich, Jr. appeared on behalf of the trustee. Jack J. Cullen, representing Cabot Corporation, also was present. The court postponed ruling on the motions until a motion and an appeal before the District Court were resolved. The District Court remanded the case to this court on April 14, 1987.

On July 1, 1981, Walter Kilimnik, sole owner and operator of American Alloy Metals, Inc. (AAM #1) for over 20 years, hired Peter

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Suriano as AAM #1's general manager. Late in 1981, Kilimnik agreed to sell AAM #1 to Suriano, who agreed to form a corporation to buy AAM #1's assets.

To effectuate this sale, Suriano incorporated Nicoti Corporation in December of 1981 to buy the assets of AAM #1. Suriano named Kilimnik the president and a director of Nicoti. During the spring of 1982, Nicoti changed its name to American Alloy Metals, Inc. (AAM #2); AAM #1, in turn, changed its name to WNK Enterprises, Inc. (WNK).

By May 1, 1982 the parties were ready to consummate the sale of AAM #1 (now WNK) to AAM #2, (formerly Nicoti, Inc). Suriano, holding all the stock in AAM #2 named himself CEO and Secretary/Treasurer; Kilimnik's wife was named director; and Kilimnik was named president, as well as made a consultant to AAM #2. The parties then executed documents, including a purchase and sale agreement, a promissory note, a working capital agreement, and an "optional advance note."

Under the terms of the promissory note, Suriano made payments to WNK on May 21, 1982; July 31, 1982; August 31, 1982; and September 30, 1982. Suriano made no further payments on the note after the September 30 payment. Suriano states that a combination of the economic downturn and Kilimnik's divorce caused the payments to stop.

On October 1, 1982, WNK assigned its interest in the promissory note and security agreement to Kilimnik. Kilimnik later filed a financing statement on October 6, 1982 that listed as collateral present and after-acquired inventory, receivables, and equipment, and proceeds from the sale thereof. The financing statement was signed by Peter Suriano, individually and for AAM #2.

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After the financing statement was filed, the parties did not discuss how the delinquent payments would be paid until the winter of 1984. In March of 1985, when the parties still failed to reach an agreement, Kilimnik served Suriano with a notice of default.

Upon receipt of the default, Suriano terminated Kilimnik as a consultant. (Kilimnik, in turn, demanded Suriano's stock, in an attempt to turn the corporation around. Suriano sold Kilimnik his stock on May 6, 1985. In September 1985, Kilimnik concluded that the corporation could not be salvaged. On September 13, he filed suit in Clark County seeking to repossess the collateral. Kilimnik incorporated AAM Aerospace and Corrosion, Inc. (ACI) on September 26, 1985.

On October 1, 1985, AAM #2 held a shareholders meeting at which a resolution was passed settling the lawsuit by waiving AAM #2's rights in the collateral. Kilimnik voted Suriano's stock by proxy. Soon thereafter a waiver of AAM #2's rights under R.C.W. 62A.9-505 was executed.

On October 2, 1985, Kilimnik took possession of AAM #2's inventory, equipment and accounts receivables, although Kilimnik did not take any assets covered by Mitsui and Co.'s security agreement and financing statement. Kilimnik notified AAM #2's customers that all accounts receivable should be paid to him. Kilimnik is operating ACI with the assets obtained from AAM #2.

An involuntary petition under 11 U.S.C. Chapter 7 was filed against the debtor on October 11, 1985. On February 28, 1986, the trustee commenced this adversary proceeding to recover assets of which Walter

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Kilimnik had taken possession on October 2, 1985. Although the trustee's complaint seeks recovery under several theories, the trustee's present motion seeks summary judgment determining that defendants took from the debtor assets not subject to a perfected security agreement. The Trustee seeks $1,624,897.82 damages for the value of the inventory and equipment taken, and also seeks a determination of defendants' liability for allegedly taking the going concern value of the debtor, with damages to be proved at

trial. In addition, the trustee seeks a preliminary injunction restricting actions by Kilimnik and ACI outside of the ordinary course of business.

On cross motion for summary judgment, the defendants seek a determination that they acquired the property in question from the debtor pursuant to the realization of a valid security interest, and not by a preferential transfer.

F.R. Civ. P. 56(c), applicable to bankruptcy proceedings through Bankruptcy Rule 7056, provides that summary judgment should be granted only "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a latter of law." In ruling on a motion for summary judgment the court must construe all pleadings, affidavits, admissions, inferences and issues of credibility in favor of the party against whom the motion is made. *Braxton-Secret v. A. H. Robbins Co.*, 769 F.2d 528, 530 (9th Cir. 1985). When cross motions for summary judgment are presented, these same standards apply to each motion. *In re*

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Kennedy, 45 B.R. 624, 626 (Bankr. E.D. Pa. 1985). The court is persuaded that the trustee's motion for partial summary judgment and a preliminary injunction should be denied, and that the defendants' motion for summary judgment should be granted in part. After reviewing the documents pertaining to the May 1, 1982 transaction, the court is convinced that Mr. Kilimnik had a perfected security interest in the assets transferred from AAM#2 to ACI.

Defendants argue that the court should read the purchase and sale agreement, promissory note and financing statement together to find an agreement by which the parties created a security interest in all of the property listed in the financing statement. *See Nolden v.*

Plant Reclamation (In re Amex-Protein Development Corp., 504 F.2d 1056 (9th Cir. 1974); *Sage v. City of Mount Vernon (In re Truckers International, Inc.)*, 17 UCCRS 1337 (Bankr. W.D. Wash. 1975). Defendants reason that paragraph 8 of the purchase and sale agreement, entitled "Security Agreement and Collateral," refers to the May 1, 1982 promissory note; that the promissory note refers to a financing statement "executed in favor of [AAM#1/WNK, Inc.] of even date herewith;" and that an undated financing statement filed October 6, 1982 describes the collateral as follows:

> All inventory, receivables, equipment, and all proceeds from the sale thereof, as well as all after-acquired inventory, receivables and equipment purchases from April 30, 1982.

The trustee argues that the financing statement filed October 6, 1982, should not be read together with the promissory note and purchase and sale agreement because the financing statement was not executed "of

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even date" with the promissory note, i.e., on May 1, 1982. The trustee established that effective July 1, 1982, the state changed the form of the official UCC-1, and that the financing statement filed October 6, 1982 was executed on the revised form. Thus, the financing statement could not have been executed "of even date" with the May 1, 1982 promissory note. Defendants seek to introduce parol evidence to show that the parties intended Kilimnik (and WNK) to have a security interest in the property described both in the purchase and sale agreement and in the financing statement.

Washington law governs admissibility of parol evidence in this proceeding. *See Vickery v. Fisher Governor Co.*, 417 F.2d 466, 468 (9th Cir. 1969); *Emrich v. Connell*, 105 Wn.2d 551, 566, 716 P.2d 863 (1986); *Dawson v. Shearer*, 53 Wn.2d 766, 767, 337 P.2d

46 (1959). The parol evidence rule applies to a writing intended by the parties as a final expression of their agreement. *Emrich v. Connell, supra,* at 556. The parties expressed their intent, in paragraph 20 of the purchase and sale agreement, that that agreement constitute their final agreement, and the court finds their intent was as expressed. However, unless an agreement is intended as a complete, exclusive expression of the parties' intent, extrinsic evidence is admissible, not to vary the terms of the agreement, but to resolve ambiguities. *Emrich v. Connell, supra,* at 556; *In re Estate of Wahl*, 99 Wn.2d 828, 831, 664 P.2d 1250 (1983). Parol evidence is not admissible to resolve an apparent ambiguity in a contract where unclear and ambiguous language can be clarified by interpreting the contract provision in pari material with the whole contract and in light

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of all circumstances. *P.U.D. No. 1 v. WPPSS*, 104 Wn.2d 353, 373, 705 P.2d 1195 (1985), *modified*, 713 P.2d 1109 (1986); *Henry v. Lind*, 76 Wn.2d 199, 201, 455 P.2d 927 (1969); *Victoria Tower Partnership v. Lorig*, 40 Wn. App. 785, 788, 700 P.2d 768 (1985). *See also Taylor-Edwards Warehouse & Transfer Co. v. Burlington Northern, Inc.*, 715 F.2d 1330, 1334 (9th Cir. 1983); *Grant County Constructors v. E. V. Lane Corp.*, 77 Wn.2d 110, 120-21, 459 P.2d 947 (1969). If at all possible, all parts of a contract should be construed so as not to conflict with one another, but rather to harmonize with one another. *See Grant County Constructors, supra.* In addition, an ambiguity should not be read into a contract if it can be avoided reasonably by reading the contract as a whole. *McGary V. Westlake Investors*, 99 Wn.2d 280, 661 P.2d 971 (1983).

Because the financing statement is not "of even date" with the promissory note, the court is unable, without resort to extrinsic evidence, to determine that the terms of the financing statement should be included in the parties' agreement through incorporation by reference *(See generally Nolden v. Plant Reclamation (In re*

Amex-Protein), 504 F.2d at 1060). In addition, because the financing statement was executed two months after the other documents, the court does not find that the financing statement and other documents should be read together under a "combination of documents" approach. *See, e.g., Sage v. City of Mt. Vernon (In re Truckers International, Inc.), supra; In re Estate of Wahl*, 99 Wn.2d at 831.) However, the purchase and sale agreement, when read as a whole, contains a security agreement that described adequately the collateral that is the subject of this dispute.

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R.C.W. 62A.9-105 defines a "security agreement" as "an agreement which creates or provides for a security interest." An agreement is defined in R.C.W. 62A.1-201(3) as "the bargain of the parties in fact as found in their language or by implication from other circumstances. . . ." A "'security interest' means an interest in personal property or fixtures which secures payment or performance of an obligation." R.C.W. 62A.1-201(37).

The May 1, 1982 purchase and sale agreement between AAM#1 (WNK) as seller and Peter Suriano and AAM #2 as buyers manifests the parties agreement to create or provide for a security interest in the assets that are also described in the financing statement. The parties provided, in paragraph 1, for sale of "the following described personal property: (a) All inventories. . . . (b) All deferred charges. . . . (c) All machinery, equipment, automobiles, office furniture and equipment. . . ." The parties also agreed that certain trade accounts receivables would remain the seller's property. In paragraph 25, the parties provided:

> 25. *UCC-1 FOR SALE.* Buyer agrees to execute a Form UCC-1 and to initial such additional sheets as may be required to describe *the items of personal property being purchased hereunder.* Seller shall be under no obligation to file same in the Office of

> Secretary of State of Washington. . . . (emphasis added).

It is apparent from paragraph 25 that the parties intended the "items of personal property" described in paragraph 1 to serve as

security for performance of the buyer's obligations under the contract. Such a reading is not inconsistent with paragraph 8:

> "8. *SECURITY AGREEMENT AND COLLATERAL.* To the extent Buyer creates accounts receivable from sales made subsequent to closing date, Buyer agrees to allow the accounts receivable as collateral for the payments which are due or to become due under the terms of the promissory note delivered to Seller as part of the purchase price. Buyer also allows his stock certificate in American Alloy Metals, Inc. to be given as collateral for the note. Buyer and Seller agree to the terms of the Working Capital Financial Agreement attached hereto and made a part hereof. . . ."

Although the title to this paragraph could be read, in isolation, to be the parties' exclusive expression of a security agreement, when harmonized with paragraphs 1 and 25, this provision should be read to provide security in addition to that for which provision was made in paragraphs 1 and 25. Paragraph 8 provides for the seller's security interest in the proceeds of inventory sold after May 1, 1982. This further suggests that the parties intended that the company's inventory would serve as security for the buyer's contract obligations. Paragraph 8 also provides for Suriano's stock certificates in AAM#2 to serve as additional security, and incorporates the security agreement pertaining to a $250,000.00 line of credit Kilimnik personally extended to AAM#2 and Suriano under

a "Working Capital Financial Agreement." None of the provisions in paragraph 8 conflicts with the parties' expressions in

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paragraph 25 of intent to provide for a security interest in the property described in paragraph 1.

The financing statement is consistent with such a reading of the purchase and sale agreement. The financing statement lists Walter Kilimnik and WNK Enterprises, Inc. as secured parties. Under the purchase and sale agreement, WNK Enterprises, Inc. is the secured party. (WNK assigned its interest to Kilimnik on October 1, 1982.) Under the Working Capital Financial Agreement and accompanying security agreement, Kilimnik individually is the secured party. The court finds that the parties intended the UCC-1 filed October 6, 1982, to serve as a financing statement for the purchase and sale agreement, and also for the working capital financial agreement which was incorporated into the former agreement. That the financing statement was not executed until sometime near July 1, 1982, is not inconsistent with paragraph 6 of the purchase and sale agreement, which provides:

> "6. *DELIVERY OF DOCUMENTS.* All documents to which Buyer is entitled hereunder, other than those provided in Paragraph 5, [*sic* 4] shall be delivered as soon as possible after the closing date, it being the intention of the parties that the delivery of all such documents shall be completed within sixty (60) days after the closing date. Following the closing date Seller will, on request of Buyer, execute and deliver to Buyer such further instruments in writing as may be required to complete or evidence the transaction herein provided for and Buyer will, on request, execute and deliver like instruments to Seller.

The court concludes that Kilimnik had a perfected security interest in the property described in the financing statement filed October 6, 1982, and described more fully in paragraphs 1 and 8 of the purchase and sale agreement. Because the parties have not supplied argument as to whether Kilimnik's foreclosure of this security interest constituted a preferential transfer, *see generally Madrid v. Lawyers Title Insurance Co. (In re Madrid)*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833 (1984), summary judgment is denied as to that issue. Similarly, the evidence presented does not establish, for purposes of the trustee's summary judgment motion, that Kilimnik wrongfully seized the going concern value of AAM#2. Summary judgment also is denied as to that issue.

The standard for evaluating the trustee's request for a preliminary injunction is set forth in *Regents of the University of California v. ABC, Inc.*, 747 F.2d 511, 515 (9th Cir. 1984):

> [A] preliminary injunction is justified when: (1) the moving party has established a strong likelihood of success on the merits; (2) the balance of irreparable harm favors the moving party; and (3) the public interest favors the issuance of an injunction.

See also Northern Alaska Environmental Center v. Hodel, 803 F.2d 466, 471 (9th Cir. 1986); 11 C. Wright, A. Miller & F. Elliott, *Federal Practice and Procedure* §2948, at 430-31 (West 1973, Supp. 1986). These factors are to be balanced by the trial court to determine whether the equities of the case favor granting a preliminary injunction. *Regents of the University of California*, 747 F.2d at 515.

Applying these factors to the facts of the present case leads the court to conclude that a preliminary injunction is not justified at

this time. First, the trustee has not established a strong likelihood of

[Page 12]

success on the merits. The parties have addressed primarily the validity of Kilimnik's security interest, and that matter has been resolved in Kilimnik's favor. The trustee has not established a prima facie case with regard to any of his other allegations.

Second, the threat of irreparable harm to Kilimnik if an injunction were granted outweighs the threat of such harm to the trustee from denying it. The proposed preliminary injunction would seriously impair Kilimnik's operation of ACI, while denying the injunction is not likely to impair significantly the trustee's ability to collect the money judgment he seeks.

Finally, the trustee has not shown that the public interest favors granting the injunction. The court concludes that a preliminary injunction is not proper at this time.

This memorandum decision constitutes findings of fact and conclusions of law, pursuant to Bankruptcy Rule 7052 and F. R. Civ. P. 52(a). A separate order on cross motions for partial summary judgment and motion for preliminary injunction accompanies this decision, in accordance with Bankruptcy Rule 9021(a).

A pretrial conference on this matter shall be held in the Chambers of the undersigned judge at 9:30 a.m. on the 25th day of June, 1987.

DATED this 20 day of May, 1987.

/signed/
ROBERT W. SKIDMORE
BANKRUPTCY JUDGE

cc: William S. Weinstein
910 5th Ave., Suite 300
Seattle, WA 98104

[Page 13]

Joseph E. Shickich, Jr.
Suite 4400, 1001 4th Ave. Plaza
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Jack J. Cullen
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APPENDIX 2

United States Bankruptcy Court,
Western District of Washington at Tacoma

In re American Alloy Metals, Inc., No. 85-02660;
Dale V. Whitesides v. Walter Kilimnik; AAM Aerospace & Corrosion International, et al. v. Cabot Corporation, Adv. No. A86-30806.

Order on Cross Motions for Partial Summary Judgment and Motion for Preliminary Injunction

May 20, 1987

This matter having come on regularly upon trustee's and defendants' cross motions for partial summary judgment, and the trustee's motion for preliminary injunction, and the court having considered the parties' motions and the files and records herein, and being duly advised in the premises; now, therefore, it is hereby

ORDERED:

(1) Defendants are granted summary judgment establishing that on October 2, 1985, Walter Kilimnik had a valid security interest in all inventories, deferred charges, machinery, equipment, automobiles, office furniture and equipment and accounts receivable of the debtor

[Page 2]

corporation. This security interest had attached and was perfected on October 6, 1982.

(2) The remainder of each of the parties' motions for summary judgment is denied.

(3) The trustee's motion for preliminary injunction is denied.

DATED this 20 day of May, 1987

/signed/
ROBERT W. SKIDMORE
BANKRUPTCY COURT JUDGE

cc: William S. Weinstein
910 5th Ave., Suite 300
Seattle, WA 98104

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APPENDIX 3

United States Bankruptcy Court,
Western District of Washington at Tacoma

In re American Alloy Metals, Inc., No. 85-02660;
Dale V. Whitesides v. Walter Kilimnik; AAM Aerospace & Corrosion International, et al. v. Cabot Corporation, Adv. No. A86-30806.

The Ruling of the Honorable Frank D. Howard

September 27, 1988

[Page 2]

APPEARANCES

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Reported by: Susan H. Brown

[Page 3]

SEATTLE, WASHINGTON; TUESDAY, SEPTEMBER 27, 1988

3:00 P.M. SESSION

--ooOoo--

THE COURT: Counsel, what I propose to do is indicate what findings I feel are substantiated, based upon the record before me together with the pre-trial order.

If either party feels I've neglected to address anything for which there should be a finding on, based upon any of your theories of the case or defense, if you will call it to my attention, I'll attempt to make that specific finding if I think the record justifies it.

As I view the proceedings, the trustee of American Alloy Metals bring this action against Kilimnik and AAM Aerospace & Corrosion, a Washington corporation, also a Nevada corporation and a California corporation, advancing a number of theories.

Mr. Kilimnik has a number of years' experience in superalloys and the corrosive metals industries. Prior to May of 1982, he was the owner and president of American Alloy Metals.

In May of 1982 he entered into an agreement whereby there was a sale of assets in a transaction with Peter Suriano, and he also took a security agreement on the tangible assets of the corporation.

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A substantial amount of the facts, up to October 11, 1985, when there was a filing of the involuntary bankruptcy petition, are set forth in the pre-trial order. I don't propose to address those again. However, the testimony and the pre-trial order essentially established the sale-of-assets transaction which occurred in May of 1982.

In May of 1985, Mr. Kilimnik came back into control of American Alloy Metals; and from that date until the involuntary bankruptcy petition, he did control the corporation, either as president, a member of the board of directors, or the controlling shareholder. He controlled it until its demise as an operating company.

In late August of 1985, or at least early September, he undertook to accelerate the note because of the default and to actually realize on his security agreement.

By mid-September, he had determined to start a new corporation which would compete directly with American Alloy Metals, if it continued to exist. September 20th was the last day for American Alloy Metals as an operating company.

On September 23rd, American Alloy Metals Aerospace & Corrosion was in operation. It had the same employees, essentially, and management. It essentially

[Page 5]

occupied or utilized the same facilities and equipment; it utilized the same forms and computers; and it also utilized American Alloy Metals customer information.

It filled some orders that had been placed with American Alloy Metals, but it appears to me that a substantial number of these were actually filled with the consent of the trustee.

On October 2nd of 1985, American Alloy Metals, in exchange for Mr. Kilimnik giving up his rights to a deficiency judgment, agreed to a non-judicial foreclosure of the note and security interest. When this agreement was reached, Mr. Kilimnik controlled American Alloy Metals. There was no one else to speak for or control the corporation.

When he took the tangible assets under the security agreement and the October 2nd agreement, American Alloy Metals no longer had the ability to continue or do business as an operating company. The new corporation, which has generally been referred to as ACI Washington, had or utilized the assets formerly of American Alloy Metals, based upon the consignment from Mr. Kilimnik. They did this at least from October 2nd on.

I think the record establishes that from the start of business on September 23rd it was understood by Mr. Kilimnik and all parties to the transaction that this

[Page 6]

would be done. There was also an additional cash infusion into ACI by Mr. Kilimnik.

The plaintiff advances a number of theories for relief; however, I think they can be substantially grouped as follows:

that the defendant took an asset of the corporation which was not covered by the security agreement, its good will, which according to the trustee should be valued at $931,275;

that the trustee is entitled to recover the value of that asset since it can't be returned to the trustee;

that the defendant, Mr. Kilimnik, breached various duties owed to the corporation or its creditors;

that the security agreement should be avoided and the trustee entitled to judgment for the value of the assets taken;

and/or that the claims of the defendant should be subordinated to the claims of other creditors;

or that the plaintiff is entitled to judgment sufficient to pay all other creditors in full against Mr. Kilimnik and the corporations on a number of theories.

Based on Judge Skidmore's ruling that the defendant had a valid security interest, that its foreclosure was technically correct, that it was not preferential, and based on this record, it would appear to

[Page 7]

me that the defendant was entitled to foreclose the security agreement.

There was a long period of default; the financial condition of the corporation, American Alloy Metals was shaky, at best; and when you consider the total amount of debt to the value of the security, he was certainly entitled to proceed with the foreclosure action.

On the record, it would appear to me that once the tangible assets of American Alloy Metals were taken, no good will existed or remained, even assuming that any existed at any time.

The good will, under Mr. Wheeler's testimony and the theory advanced by the trustee, was dependent on the existence of operating assets; facilities; suppliers; customer base; and management, including Mr. Kilimnik or his equivalent replacement.

When the security interest was foreclosed, the good will – again, I am assuming it existed, without so finding – ceased to exist, based solely on the taking or the imminent taking of the tangible assets.

On this record, there was not a taking of intangibles improperly by the defendant; it just ceased to exist, under Mr. Wheeler's testimony, once the taking of those assets became imminent.

The trustee advances a number of other theories

[Page 8]

based essentially, upon the acts and conduct of the defendant Kilimnik when in control of American Alloy Metals and ACI. He also advances that the conduct, when viewed as a whole, was inequitable to other creditors.

I have already indicated that I am satisfied on the record that essentially from May on he was the controlling figure, as far as American Alloy Metals was concerned. He made a determination to foreclose the security interest, either in late August of 1985 or early September of that year; and this was effectively accomplished as of October 2, 1985. The effect of this was to put American Alloy Metals out of business.

Shortly before this, a new corporation was set up, which used the assets which were taken or were about to be taken under the security agreement. They hired essentially the same personnel as American Alloy Metals, used basically the same facilities, contacted the same customers, and solicited the same customer base. I have already indicated that they filled some orders which were originally placed with American Alloy Metals.

While in control of American Alloy Metals, Mr. Kilimnik took some steps with creditors to reduce certain inventories. It would appear to me that from June 1st to October 1st creditors were paid well over $1 million by American Alloy Metals. Ninety days before the bankruptcy,

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or within the 90-day period before the involuntary bankruptcy filing, the creditors were paid approximately $780,000 on the indebtedness.

Also the current liabilities were slightly reduced during the period Mr. Kilimnik was in control of the corporation, although the inventory increased overall by approximately $28,000.

It would also appear to me that creditors were informed, if it came up, of his security interest, especially the gentleman from the Mitsui Corporation.

Once the assets were taken or were about to be taken, American Alloy Metals had no ability to perform.

On this record, it would appear to me that where a secured creditor properly foreclosed a security agreement, that no duty to other creditors and/or to the corporation to continue it in existence as a going business remained. Even if there was a technical breach by Mr. Kilimnik in that he controlled both American Alloy Metals

and ACI, or that he intended to set up ACI after the foreclosure, there was no damage to the creditors as a whole.

Certainly there was a benefit, on this record, to Mr. Kilimnik by his actions, in that he had the benefit of essentially putting in ACI as a going corporation; but I find no corresponding detriment or injury to the creditors

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as a whole.

Accordingly, I would propose to dismiss the trustee's actions with prejudice as against the defendants and the corporations, except as to the following:

The $75,000 preference, which I have already addressed, it would appear to me that that should be due interest since the date of payment.

It would also appear to me that the $2,000 transaction pertaining to the preferred stock was also a preferential treatment and that they would be entitled to judgment for that amount, together with interest from the date of the transaction.

As to the liquid-asset-management accounts, absent something further, it would appear to me that that would be covered, on this record, by the security agreement.

The same would be true of the Royal Oaks transaction.

Counsel, is there anything that either the trustee or the defendants think I have neglected to address?

MR. HACKER: Yes, Your Honor. I would like to address the Court on the ruling with respect to pre-judgment interest, at the appropriate time.

THE COURT: Well, let me indicate this, counsel:

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I would propose to consider your position on that at the time that the findings are presented. Is there any reason why you couldn't send me very briefly in writing anything in addition which you wish to submit before those are presented?

MR. HACKER: Perhaps, with Your Honor's permission, I could ask counsel -- I am not sure they are asking for interest from the date of the transaction; it might be just from the complaint date.

MR. SHICKICH: As I understand the case law, Your Honor, it is from the complaint date.

MR. HACKER: That clarifies it.

THE COURT: All right. Anything else?

MR. SHICKICH: Your Honor, let me ask you a question on the LAMA account. I am not sure that I understood your last point.

THE COURT: All right. It seems to me, on the record before me, that they would be entitled to the liquid-asset-management account funds, based upon the security agreement.

I will consider, if you want to submit me something very briefly in writing, as to why that would not be the proper result on this record. I would consider that at the time that the findings are presented.

Anything else from the trustee's standpoint?

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MR. SHICKICH: No, Your Honor.

THE COURT: All right. From the defendants' standpoint?

MR. HACKER: Yes, Your Honor. I would like to reserve the question of attorneys' fees, perhaps to the time of presentation of the findings.

THE COURT: Let me ask counsel for Cabot Corporation: Is there any way that you feel there is jurisdiction?

MR. WILLERT: Your Honor, after looking into the matter, both legally and the facts hereof, I cannot, in good conscience, tell the Court that I believe you have jurisdiction.

THE COURT: Is there anything as a practical consideration that you would like me to consider or that I could consider?

MR. WILLERT: Practically speaking, Your Honor, I would like you to hear the case; but I don't think you can.

THE COURT: All right.

MR. WILLERT: I don't think there is anything that you can do but enter an order saying you have no jurisdiction.

THE COURT: Anyone disputing that?

All right. I'll sign such an order upon presentation, either approved by counsel or after notice.

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Counsel, let me indicate that later on if either party thinks there is any finding that I have neglected to make upon any of your theories, if you will call it to my attention, I'll be glad to attempt to do it, if I feel I can on the record.

We'll be in recess.

(At 3:20 p.m., the hearing concluded.)

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CERTIFICATE

I do hereby certify that the above transcript is a true and complete transcription of the judge's ruling given on the 27th day of September 1988.

Signed and dated this 28th day of September 1988.

/s/

Court Reporter

APPENDIX 4

United States Bankruptcy Court
Western District of Washington at Tacoma

In re American Alloy Metals, Inc., No. 85-02660T; *Dale V. Whitesides v. Walter Kilimnik; AAM Aerospace & Corrosion International, et al.*, Adv. No. A86-30806T.

Findings of Fact and Conclusions of Law

February 3, 1989

This Adversary Proceeding having been tried to the court between September 12-27, 1988, the court hereby makes the following findings of fact and conclusions of law:

[Page 2]

I. *FINDINGS*

1. These findings incorporate the admitted facts from the pretrial order entered herein on or about 8/24/88. True and complete copies of ¶ 3.1 through 3.45 of the pretrial order are attached hereto as Exhibit A.

2. Pursuant to B.R. 52 and F.R.C.P 52(a), the findings of the facts stated by court orally on 9/27/88 are adopted as findings herein as expanded upon more fully below. A true and complete copy of the court's oral ruling of September 27, 1988 is attached hereto as Exhibit B.

3. From and after May 1985, Kilimnik exercised the full management and control of Debtor and directed its affairs in their entirety.

4. Between May and October 1985, Debtor's business prospects improved. The opportunity for the Debtor to operate profitably existed.

5. Kilimnik held the irrevocable proxy of 100% of Debtor's stock from 5/10/85. He had and exercised the power to appoint the board of directors, the officers and the employees.

6. In the court's oral ruling (Ex. B), when the court speaks of "creditors" (9/27/88 Oral Ruling at 8, 9 and 10), the court means any and all creditors of Debtor between May-October 1985. This is in contrast to the creditors in this bankruptcy estate.

[Page 3]

7. The creditors in this bankruptcy estate (the "bankruptcy creditors"), of which the plaintiff trustee is the representative, are those listed in Debtor's schedules.

8. The Debtor incurred claims with all of these bankruptcy creditors while Kilimnik was its president. The Debtor incurred claims with many of these bankruptcy creditors after May 1985 when Kilimnik was in complete control of Debtor.

* * *

[Page 5]

13. The unpaid account of Altemp Alloys arose from purchase orders made by Debtor as follows: purchase order no. 1750, dated 8/15/85, in the amount of $22,689.74 and purchase order no. 1765, dated 8/28/85, in the amount of $3,717. These

were larger orders than the Debtor had in the past placed with Altemp Alloys.

14. The unpaid account of Cabot Wrought Products Division arises from Debtor's orders of inventory. Debtor was a distributor for Cabot. Cabot was its major supplier.

15. The unpaid account of A.M. Castle & Company arose from purchase orders made by Debtor as follows: purchase order no. 1623, dated 5/3/85, in the amount of $11,627.97 and purchase order no. 1694, dated 7/8/85, in the amount of $577.20.

16. In foreclosing on his note, opening AAM Aerospace & Corrosion International and having Debtor renounce its interest in collateral, Kilimnik intended, if possible, to place his own interest, which he believed to be secured, ahead of the interests of Debtor's creditors.

[Page 6]

17. The unpaid account of Metal Goods arose from a purchase order made by Debtor as follows: purchase order no. 1650, dated 5/30/85, in the amount of $8,927.80.

18. The unpaid account of Southwestern Alloys, Inc. arose from a purchase order made by Debtor as follows: purchase order no. 1657, dated 6/5/85, in the amount of $2,848.09.

19. The unpaid account of Williams and Company, Inc. arose from a purchase order made by Debtor as follows: purchase order no. 1771, dated 8/27/85, in the amount of $33,350.80. This was a larger order than the Debtor had in the past placed with Williams and Company.

20. American Alloy Metals and AAM Aerospace & Corrosion International had:

same officers

same controlling director--Walter N. Kilimnik

same shareholder control--Walter N. Kilimnik

same attorney--Rick Potter who had represented the Debtor in the past

same management

a number of the same employees with same job responsibilities

same type and kind of service

same in-house order forms

same logo ("AAM")

a number of the same customers and customer information

same customer mailing list/rolodex

same facilities

[Page 7]

same equipment

same premises

same lease

same computer

same forms

essentially the same financial accounting format

the insurance was transferred from Debtor into the name of AAM Aerospace & Corrosion International

same telex and used similar office procedures

same banking relationship

same control of mail receipt

same control of stationary

Some of Debtor's customers believed that AAM Aerospace & Corrosion was the same company as Debtor except for a name change.

21. In the metals industry, American Alloy Metals was known as "AAM".

22. In March, June and September 1985, in person and by telephone, Kilimnik gave Cabot assurance about his managerial support and control of Debtor.

23. In June 1985, Kilimnik gave assurance to Mitsui about his managerial support and control of Debtor.

24. After this, Cabot continued to supply Debtor with new inventory and deferred for a period of time collection efforts on Debtor's past-due account.

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25. Debtor paid $75,000 to defendant Kilimnik on or about August 12, 1985. It also paid $2,000 to defendant Kilimnik on or about August 23, 1985.

26. The $75,000 payment was made to Kilimnik as a creditor, and was made for or on account of an antecedent debt. The $2,000 payment was made by the corporation to Kilimnik as a stockholder in redemption of preferred stock.

27. These payments while Debtor was insolvent.

28. These payments were made less than 90 days before the filing of the bankruptcy petition.

29. These payments enable Kilimnik to receive more than he would have received if the payments had not been made and Kilimnik had been relegated to the status of the claimant under a Chapter 7 bankruptcy proceeding.

30. The court retracts its finding, in its oral ruling at pages 8 and 9, "that from June 1 to October 1 creditors were paid well over $1,000,000 by American Alloy Metals. Ninety days before the bankruptcy, or within the 90-day period before the involuntary bankruptcy filing, the creditors were paid approximately $780,000 on the indebtedness." There was no evidence at trial to substantiate ~~this finding.~~ these dollar amounts. The court finds that substantial payments were made to creditors during the 90 days before the bankruptcy filing. FDH

31. Suriano had incorporated Nicoti Corporation in December 1981. During the spring of 1982, Kilimnik's American Alloy Metals, Inc. changed its name to WNK Enterprises, Inc. Nicoti Corporation changed its name to American Alloy Metals, Inc., the Debtor. Suriano

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was the sole shareholder of the Debtor. The Debtor was essentially a commodities business, engaged in the purchase and sale of metal alloy products. The identities of the customers for these products were available in the metal alloy industry, although it required some work to prepare the list.

32. Suriano and the Debtor also assumed $382,073.83 worth of trade payables. Kilimnik took a security interest in the assets sold to Suriano and the Debtor, the proceeds from sale of those assets, after-acquired inventory and equipment of Suriano and the Debtor, accounts receivable created by Suriano and the Debtor from sales made after May 1, 1982, and Suriano's stock in the Debtor, as reflected in Judge Skidmore's May 20, 1987 partial summary judgment.

33. Thereafter, on October 1, 1982, the note and underlying security were assigned by WNK Enterprises to Kilimnik individually. The security interest was perfected by the filing of a UCC-1 financing statement with the Washington Department of Licensing on October 6, 1982.

34. Suriano agreed Kilimnik would not be expected to nor would he assume any obligations or liabilities of Suriano or AAM.

35. On July 8, 1985, Kilimnik suffered a cardiac arrest. He was initially hospitalized from July 8 through July 18. He spent a week in the Intensive Care Unit where he developed evidence of cardiogenic shock and congestive heart failure. He was hospitalized a second time, in intensive care, from July 23 to July 27, 1985. He

was hospitalized a third time, from September 4, 1985 to September 13, 1985.

36. On August 22, 1985, a special meeting of Debtor's Board of Directors was held at Kilimnik's home.

37. In the court's oral ruling (at page 5, lines 4-7), when the court talks about "a substantial number" of orders being filled with the trustee's consent, the court is referring to the following: First, during the pendency of Debtor's bankruptcy proceedings, the trustee consented to allowing McDonnell Douglas to cancel a pre-bankruptcy order with Debtor and have it filled by AAM Aerospace & Corrosion International (Exhibit 207). Second, during the pendency of Debtor's bankruptcy proceedings, the trustee also consented to allowing Kilimnik to return to Jessop Steel foreclosed inventory in exchange for a credit.

38. The LAMA account was related to the Debtor's accounts receivable and consisted of cash. This repossession was predicated upon the advice of counsel as part of Kilimnik's security interest.

39. AAM Aerospace & Corrosion International did not purchase the Debtor's assets from the Debtor; rather, it obtained the inventory by consignment from Kilimnik and it leased certain other personal property from Kilimnik. AAM Aerospace & Corrosion International did not deal with anyone other than Kilimnik concerning the Debtor's former assets. AAM Aerospace & Corrosion International did not expressly assume the Debtor's liabilities and there was no implied assumption of the Debtor's liabilities.

40. There is no evidence that any shares of stock of AAM Aerospace & Corrosion International were transferred to the Debtor. AAM Aerospace & Corrosion International dealt only with Kilimnik concerning the Debtor's former assets and any consideration passed between AAM Aerospace & Corrosion International and Kilimnik and none passed to the Debtor. One of Kilimnik's purpose in foreclosing on his security interest was to settle his pending lawsuit against the Debtor.

41. On the record before me, I find that, inasmuch as the LAMA account was related to the Debtor's accounts receivable and such receivables were subject to the Kilimnik's security interest, the LAMA account was subject to Kilimnik's security interest.

42. Kilimnik relinquished a deficiency claim of approximately three million dollars upon foreclosure of his security interest.

43. Between May and September 1985, Cabot shipped new material for which it was paid and its pre-May 1985 debt was slightly reduced.

44. Kilimnik was not present in Debtor's offices during periods in July and August because of a serious heart attack.

45. The Debtor's employees were offered employment at AAM Aerospace & Corrosion International by Kilimnik or Marvin Wheeler.

II. *CONCLUSIONS OF LAW*

1. Pursuant to B.R. 52 and F.R.C.P. 52(a), the conclusions of law stated orally by the court on September 27, 1988

(Ex. B hereto) are adopted as conclusions herein as expanded upon more fully below.

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2. Kilimnik received preferential payments from Debtor on August 12 and 23, 1985 in the amounts of $75,000 and $2,000 respectively.

3. Except for these preference claims, the trustee's other claims should be dismissed with prejudice.

4. Partial summary judgments entered herein on May 20, 1987 and March 22, 1988 shall now be deemed final orders for purposes of appeal.

5. In addition, the plaintiff is entitled to prejudgment interest on the amount of the preferential transfers, a post-petition claim, payable for the period from the date the plaintiff's complaint was filed until the date of entry of the judgment herein.

6. Since AAM Aerospace & Corrosion International did not purchase the Debtor's assets from the Debtor, AAM Aerospace & Corrosion International did not become a successor corporation to the Debtor and is not subject to successor liability.

7. AAM Aerospace & Corrosion International did not expressly or impliedly assume any of the Debtor's liabilities. There was no *de facto* merger or consolidation between Debtor and AAM Aerospace & Corrosion International.

DATED February 3, 1989.

/signed/

The Honorable Frank D. Howard
United States Bankruptcy Court Judge

Presented by:

RIDDELL, WILLIAMS, BULLITT & WALKINSHAW

By: _____/signed/_____
Joseph E. Shickich, Jr.
Attorneys for Trustee

~~Proof of Entry;~~ copy received;
notice of presentation waived:

WEINSTEIN, HACKER, YOST, BERRY &
& MATTHEWS, INC., P.S.

By: _____/signed/_____
Donald P. Hacker, Jr.
Attorneys for Defendant

EXHIBIT A
(TO FINDINGS OF FACT AND CONCLUSIONS OF LAW)

[Pre-Trial Order on Trustee's Action - Page 2]

* * *

III. ***ADMITTED FACTS***

3.1 American Alloy Metals, Inc. ("AAM" or "Debtor") was a Washington corporation. Its principal place of business was Vancouver, Washington.

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3.2 Debtor was a distributor and service center of super-alloy and corrosive metals for metal fabricators and manufacturers. Its clients included a wide range of industries including aerospace, chemical processing, pollution control, mining, pulp and paper, jet engine and furnace manufacturing.

3.3 Debtor had an extensive inventory of super-alloys available for sale.

3.4 Kilimnik obtained a metallurgy degree in 1941 from the University of Illinois. He then served as a World War II bomber pilot. After the war, he worked in the aviation and metals industry in California, employed by Lockheed Aircraft, U.S. Steel and Carlton Forge Works.

3.5 In 1965, Kilimnik opened his own business, American Alloy Metals, Inc., in Paramount, California. It was a California corporation and Allan Carlton and Walter Kilimnik were its only shareholders. In 1975, Kilimnik formed another business, American Alloy Metals, Inc., in Nevada. He was the sole shareholder. In 1980, he moved to Vancouver, Washington, merged the California and Nevada corporations and formed American Alloy Metals, Inc., a Washington corporation of which he was the sole shareholder.

3.6 After moving to Vancouver, Kilimnik began using the Portland office of the Price Waterhouse accounting firm. There he met Peter Suriano ("Suriano") who became Kilimnik's personal and American Alloy's corporate accountant for a period of approximately two years.

3.7 On July 1, 1981, Suriano left Price Waterhouse and became employed as the General Manager of American Alloy.

Kilimnik was its President. Kilimnik and his wife, Kathleen, were its directors.

3.8 By May 1982, Kilimnik and Suriano had agreed on a purchase and sale transaction. The transaction was evidenced by, *inter alia*, a document entitled "Agreement for Sale of Assets of WNK Enterprises, Inc., formerly known as American Alloy Metals, Inc." (the "Purchase and Sale Agreement"). The agreement was dated May 1, 1982. Pursuant thereto, Suriano made a down payment of $50,000 and American Alloy and Suriano executed an installment note for $3,950,000 (the "Promissory Note").

3.9 In the transaction, the Debtor obtained the right to use the American Alloy Metals name. After the transaction, Walter Kilimnik was President of the Debtor and Kathleen Kilimnik was its Secretary. Suriano and Mrs. Kilimnik were the only directors. Suriano was the General Manager and the sole Shareholder.

3.10 Also on May 1, 1982, Kilimnik entered into an Employment Contract with American Alloy Metals. Kilimnik served as American Alloy's President from May 1, 1982, until his resignation on October 1, 1985, except for a period of time from May 1 to May 14, 1985.

3.11 The Promissory Note was made payable from American Alloy and Suriano to WNK Enterprises, Inc. It called for monthly installment payments of $75,000 on or before the 15th day of each month beginning in July 1982 and continuing until the note was paid in full. Monthly installment payments were made in July 1982, August 1982 and September 1982. Thereafter,

on October 1, 1982, the note was assigned by WNK Enterprises to Kilimnik individually. Another payment was made in August 1985.

3.12 In June 1983, Kathleen Kilimnik resigned as an officer and director of the corporation. The corporation bylaws were amended to provide for a single director and Suriano, as the sole shareholder of the Debtor, elected himself as the sole director. For officers, Suriano elected Kilimnik as President and Suriano as Secretary/Treasurer.

3.13 On January 21, 1985, Kilimnik's divorce trial began in Clark County Superior Court. During the trial, Mr. and Mrs. Kilimnik reached a settlement. Mr. Kilimnik was awarded the Promissory Note from American Alloy Metals.

3.14 At some point, Kilimnik gave Suriano and American Alloy Metals a notice of default on the unpaid Promissory Note. The notice is dated March 21, 1985.

3.15 On March 25, 1985, Kilimnik and Suriano flew together to Pittsburgh, Pennsylvania and visited Allegheny Ludlum Steel Corporation.

3.16 On March 26, 1985, Kilimnik and Suriano flew together to Indianapolis, Indiana and then went to Kokomo for a meeting at the corporate headquarters of Cabot Corporation.

3.17 On March 27, 1985, Kilimnik and Suriano returned to Vancouver, Washington.

3.18 On March 27, 1985, a special directors' meeting was conducted by Suriano, the sole director, in which the corporation resolved not to renew Kilimnik's employment contract and directed

that Kilimnik be notified that his corporate authority was being revoked.

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3.19 By a letter dated April 3, 1985, from attorney J.D. Nellor, Kilimnik was notified that his employment contract would not be renewed on May 1, 1985. The letter stated that his authority to act as President of the corporation was "revoked immediately."

3.20 Thereafter, a series of negotiations occurred between Kilimnik and Suriano and attorneys Rick Potter and J.D. Nellor. The negotiations culminated in a written "Agreement," dated May 10, 1985, with the following provisions, among others:

a. Suriano gave Kilimnik an irrevocable proxy to vote all of Suriano's stock in the corporation;

b. Suriano resigned from any and all positions in the corporation;

c. Suriano agreed to turn over to Kilimnik all the books, records and customer lists of the corporation;

d. Suriano transferred his ownership in the phone system, which he had purchased personally, to Kilimnik;

e. Suriano's banking authority was revoked;

f. Suriano received from American Alloy Metals $47,424.41 in cash and the transfer of title to a 1977 Dodge station wagon.

g. Kilimnik released Suriano from his personal liability on the Promissory Note effective as of January 15, 1986.

3.21 On May 14, 1985, Kilimnik and Rick Potter were elected to the board of directors. Kilimnik was elected President and Vice President and Marv Wheeler was elected Secretary and Treasurer. Kilimnik was authorized to open up a corporate bank account at Sea-First.

[Page 7]

3.22 On July 8, 1985, Kilimnik had a heart attack. He was hospitalized from July 8 through July 18.

3.23 At the end of July 1985, American Alloy Metals moved out of Kathleen Kilimnik's warehouse and into a new office and warehouse space at Units F-2 and F-3, 2700 N.E. Andresen Road. Its lessor was Archer-Harrington Industrial Park.

3.24 On August 12, 1985, American Alloy Metals paid Walter Kilimnik $75,000 by American Alloy Metals check No. 5221.

3.25 On August 22, 1985, a special meeting of the American Alloy Board of Directors was held. Present were Kilimnik, attorney Rick Potter and accountant Stan Renecker. At the meeting the corporation was directed to resume making the $75,000 per month Promissory Note payments to Kilimnik and to redeem the 2,000 shares of preferred stock issued to Kilimnik on May 6, 1985. Thereafter, on August 23, 1985, Kilimnik received $2,000 from American Alloy Metals for redemption of the preferred stock.

3.26 On August 29, 1985, Kilimnik gave American Alloy Metals a "Notice of Intent to Declare Default and Acceleration of Principal and Interest Owing on Promissory Note." The Notice said that the outstanding principal and interest totalled $5,403,936.95 and that Kilimnik intended to declare a default and accelerate the whole of the principal if payment was not made within 13 days (i.e., on Monday, September 9, 1985).

3.27 Kilimnik was hospitalized again from September 3 until September 13, 1985.

3.28 On September 13, 1985, Kilimnik through attorney Richard Saunders commenced a lawsuit in the Clark County

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Superior Court: *Kilimnik v. American Alloy Metals, Inc.*, Cause No. 85-2-02315-7.

3.29 On or about September 15, 1985, Kilimnik signed and acknowledged Articles of Incorporation for a new corporation called AAM Aerospace and Corrosion International, Inc. The Articles said that the purpose of this corporation was "to engage in the wholesale aerospace and corrosion metal sales business." The Articles were prepared at the offices of Blair, Schaefer, Potter & Horton, where Rick Potter was an attorney. Rick Potter was listed as the registered agent. On or about September 15, 1985, Kilimnik also signed the bylaws of the new corporation as its President.

3.30 On September 18, 1985, attorney Rick Potter appeared and answered the complaint in *Kilimnik v. American Alloy Metals, Inc.*, on behalf of American Alloy Metals.

3.31 On September 26, 1985, the Articles of Incorporation of AAM Aerospace & Corrosion International, Inc. were filed with the Washington Secretary of State. The next day the first meeting of shareholders of AAM Aerospace & Corrosion International, Inc. was held at Rick Potter's office with Potter and Kilimnik in attendance.

3.32 On or about September 26 or 27, 1985, a letter was mailed to customers of metal goods from AAM Aerospace & Corrosion International, Inc. and was signed by Kilimnik as the President. The letter said that:

> ...I have formed a new organization. I will continue my commitment to offer you the full advantages of an independent Metal Service Center.
>
> The birth of *AAM Aerospace and Corrosion International,*
>
> [Page 9]
>
> *Inc.*, was based on the products and services repeatedly sought by our many friends.

(Emphasis in original.) The letter said that AAM Aerospace & Corrosion International, Inc.'s employees would include Mark R. Heath, Pamela Comstock, Susan Manlove, Robert Shanahan, Patrick D. Schuur and David Bordelon.

3.33 On September 27, 1985, attorney Saunders filed a summary judgment motion in the Clark County Superior Court action on behalf of Kilimnik against American Alloy Metals.

3.34 On September 30, 1985, Kilimnik gave American Alloy Metals a letter in which he resigned as President and Vice President of American Alloy Metals and as Director and Chairman of the Board of Directors, effective October 1, 1985.

3.35 On October 1, 1985, Cabot Corporation's Portland attorneys, Lindsey, Hart, Neil & Weigler, sent a demand letter to American Alloy Metals. The letter said that, unless payment was made immediately, a lawsuit would be commenced.

3.36 On October 1, 1985, a special shareholder's meeting was held of American Alloy Metals. Present were Kilimnik, proxy of all of Suriano's shares, and Marv Wheeler, Secretary of American Alloy Metals. At the meeting, the resignations of Potter and Kilimnik as directors were accepted. The minutes reflect the following discussion:

It was then brought to the attention of those present at the meeting that on September 13, 1985, a lawsuit was filed against the corporation by Walter Kilimnik seeking judgment against the corporation for the amount of Five Million Four Hundred Three Thousand Nine Hundred Thirty-Six Dollars and 95/100 ($5,403,936.95) for an indebtedness due from the corporation to Mr. Kilimnik. It was discussed and determined that the indebtedness was due and owing and there was no defense to the lawsuit. It was then brought to the attention of those present that the plaintiff's attorney had

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indicated that they would settle the lawsuit and release the corporation from any amount owing for this indebtedness if the corporation would waive its rights in the collateral pursuant to RCW 62A.9-505 and allow Walter Kilimnik to retain the inventory, equipment, receivables and proceeds securing the indebtedness which is the subject for the lawsuit pursuant to RCW 62A.9-505. It was agreed that it was in the best interest of the corporation to settle the lawsuit seeking a judgment in excess of $5 million ($5,000,000) for the release of the security for the indebtedness which has a value of less than $3 million ($3,000,000).

Then Kilimnik, proxy for the sole shareholder, adopted the following resolution:

Therefore, it was resolved that Marv Wheeler is authorized to execute a statement on behalf of the corporation waiving its rights in the collateral, securing the indebtedness discussed above in full in complete settlement of the above-mentioned lawsuit. It was generally agreed that since this action would prevent Walter Kilimnik from pursuing any deficiency judgment or difference between the value of the

collateral retained and the indebtedness owed that the above action is in the best interest of the corporation.

3.37 On October 2, 1985, American Alloy, pursuant to its resolution, executed a document in favor of Kilimnik entitled "Statement of American Alloy Metals, Inc. Waiving Rights Under RCW 62A.9-505."

3.38 On October 2, 1985, Kilimnik withdrew $104,631.79 from Liquid Assets Management Account ("LAMA") No. 719-013709 at Seattle-First National Bank, Vancouver.

3.39 On October 2, 1985, Cabot Corporation commenced a lawsuit against American Alloy Metals in Clark County Superior Court under Cause No. 85-2-02528-1.

3.40 On October 11, 1985, an involuntary bankruptcy petition under Chapter 7 was filed against American Alloy Metals by Cabot Corporation, Altemp Alloys and A.M. Castle & Co. On or about October 18, 1985, A.M. Castle & Co. withdrew its consent to the

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involuntary petition. On or about November 25, 1985, Williams & Company, Inc. filed a joinder to the involuntary petition.

3.41 On February 23, 1986, the Trustee commenced this Special Litigation against Kilimnik and ACI.

3.42 On February 24, 1986, AAM Aerospace & Corrosion International, Inc. filed Articles of Amendment with the Washington Secretary of State to change its name to Aerospace & Corrosion International, Inc.

3.43 In March 1987, a Nevada corporation, known as Standard Toner Corporation, amended its articles to read that "the

name of this corporation shall be Aerospace and Corrosion International, Inc." Its business address is 201 East Tenth Street, Marcus Hook, Pennsylvania 19061. Its sole shareholder is Kilimnik. It is referred to herein as ACI-Pennsylvania.

3.44 About October 1, 1987, another corporation known as Aerospace and Corrosion International, Inc. was incorporated in California. Its stock is owned by Kilimnik. It is referred to herein as ACI-California.

3.45 On December 28, 1987, this Court granted the Trustee's request to add ACI-Pennsylvania and ACI-California as defendants.

* * *

APPENDIX 5

United States Bankruptcy Court,
Western District of Washington at Tacoma

In re American Alloy Metals, Inc., No. 85-02660; *Dale V. Whitesides v. Walter Kilimnik; AAM Aerospace & Corrosion International, et al. v. Cabot Corporation*, Adv. No. A86-30806T.

(1) Order for Judgment against Walter Kilimnik and in favor of Trustee; and (2) Order for Dismissal of Remaining Claims of Trustee

February 3, 1989

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that:

1. *Judgment*: Plaintiff shall be awarded and the Clerk shall forthwith enter judgment against defendant Walter Kilimnik for the

[Page 2]

principal judgment amount, interest to date of judgment, post-judgment interest, and costs as provided below.

2. *Judgement Creditor*: Zachary Stoumbos as the successor trustee for the debtor, American Alloy Metals, Inc.

3. *Judgement Debtor*: Walter Kilimnik.

4. *Principal Judgment Amount*: $77,000.00.

5. *Prejudgment Interest to Date of Judgment*: Based upon the records maintained by the United States Court Clerk for the Western District of Washington and pursuant to the directives of 28 U.S.C. § 1961, the interest rate applicable at the time of the filing of this adversary proceeding was 7.71% per annum. Plaintiff therefore is entitled to prejudgment interest of $18,860.03, which is interest on the sum of $77,000 at the rate of 7.71% per annum, compounded annually, from the date this action was filed to entry of judgment herein (2/23/86 to 2/3/89: 2 years plus 346 days).

6. *Post-judgment Interest*: Pursuant to 28 U.S.C. § 1961, interest on the total of the principal amount plus all interest accrued at the prejudgment rate to that time ($77,000 plus $18,860.03 = $95,860.03 as of 2/3/89) shall be calculated at the rate of interest pursuant to 28 U.S.C. § 1961 applicable on the date of this judgment's entry, until paid.

~~7. *Costs*: Costs shall be awarded to plaintiff and the Clerk shall tax costs against defendant upon plaintiff's presentation of a bill of costs.~~ FDH

[Page 3]

8. *Dismissal with Prejudice*: Except for the judgment set forth above, the trustee's other claims against defendants shall be dismissed with prejudice.

DATED this 3rd day of February, 1989.

/signed/
HONORABLE FRANK D. HOWARD
BANKRUPTCY COURT JUDGE

Presented by:

RIDDELL, WILLIAMS, BULLITT &
WALKINSHAW

By: /signed/
Joseph E. Shickich, Jr.
Attorneys for Plaintiff

Copy received: notice of presentation
waived; approved for entry:

WEINSTEIN, HACKER, YOST, BERRY &
MATTHEWS

By: /signed/
Donald E. Hacker, Jr.
Attorneys for Defendants

APPENDIX 6

United States Bankruptcy Court,
Western District of Washington at Tacoma

In re: AMERICAN ALLOY METALS, INC.; No. 85-02660T;
ZACHARY H. STOUMBOS v. WALTER KILIMNIK, et al., Adv. No. 86-30806T

Order Denying Trustee's Motion for Reconsideration Regarding Damages

September 2, 1988

THIS MATTER having come before the court on the motion of the Trustee for reconsideration regarding the issue of damages; the court having reviewed the record and pleadings herein, having considered the arguments of counsel at the hearing on

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December 7, 1988 and the court being otherwise fully advised in the premises; and the court finding that there is no basis on which to change its original ruling on this issue; now, therefore,

IT IS HEREBY ORDERED that the Trustee's motion for reconsideration regarding damages is denied.

SO ORDERED this 18 day of January, 1989.

/signed/
The Honorable Frank D. Howard
United States Bankruptcy Judge

Presented by:

WEINSTEIN, HACKER, YOST,
BERRY & MATTHEWS, INC., P.S.

By_____/signed/_____
Donald E. Hacker, Jr.
Attorneys for Defendants

Approved as to Form, Notice
of Presentation Waived:

RIDDELL, WILLIAMS, BULLITT &
WALKINSHAW

By_____
Joseph E. Shickich, Jr.
Attorneys for Plaintiff/Trustee

APPENDIX 7

United States Bankruptcy Court, Western District of Washington at Tacoma

In re: AMERICAN ALLOY METALS, INC.; No. 85-02660T; *ZACHARY H. STOUMBOS v. WALTER KILIMNIK, et al.*, Adv. No. 86-30806T

Order Denying Trustee's Motion for Reconsideration Regarding Equitable Subordination and Successor Liability; January 18, 1989

THIS MATTER having come before the court on the motion of the Trustee for reconsideration regarding the issues of equitable subordination and successor liability; the court having reviewed the record and pleadings herein, having

[Page 2]

considered the arguments of counsel at the hearing on December 7, 1988 and the court being otherwise fully advised in the premises; and the court finding that there is no basis on which to change its original ruling on these issues; now, therefore,

IT IS HEREBY ORDERED that the Trustee's motion for reconsideration regarding equitable subordination and successor liability is denied.

SO ORDERED this 18 day of January, 1989.

/s/
The Honorable Frank D. Howard
United States Bankruptcy Judge

Presented by:

WEINSTEIN, HACKER, YOST,
BERRY & MATTHEWS, INC., P.S.

By /s/
Donald E. Hacker, Jr.
Attorneys for Defendants

Approved as to Form, Notice
of Presentation Waived:

RIDDELL, WILLIAMS, BULLITT &
WALKINSHAW

By _____
Joseph E. Shickich, Jr.
Attorneys for Plaintiff/Trustee

APPENDIX 8

United States District Court for the
Western District of Washington at Tacoma

In re: AMERICAN ALLOY METALS, INC.; ZACHARY STOUMBOS v. WALTER KILIMNIK, et al., No. C89-208T

Order

September 28, 1990

THIS MATTER comes on before the above-entitled Court upon Appeal from the United States Bankruptcy Court.

Having considered the entirety of the records and file herein, it is now

ORDERED that the decision of the United States Bankruptcy Court is AFFIRMED in its entirety.

The clerk of the court is instructed to send uncertified copies of this Order to all counsel of record.

DATED this 28th day of September, 1990.

/signed/
UNITED STATES DISTRICT JUDGE

APPENDIX 9

United States Court of Appeals
for the Ninth Circuit

ZACHARY STOUMBOS, Plaintiff-Appellant v. WALTER KILIMNIK, et al., Defendant-Appellee,
No. 91-35524

ZACHARY STOUMBOS, Plaintiff-Appellant/Cross-Appellee v. WALTER KILIMNIK, et al., Defendant-Appellee/Cross Appellant
No. 91-35525

OPINION

March 9, 199

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SUMMARY
Bankruptcy/Fraudulent Conveyances/Preferential Transfers

The court of appeals reversed, in most respects, a district court affirmance of a bankruptcy court decision, remanding for further proceedings. The court held, among other things, that a creditor's claim that his security interest in certain equipment and inventory extended to property acquired after the date of a purchase agreement lacked the necessary support of appropriate, express language in the agreement.

Walter Kilimnik founded AAM corporation and served as president and sole shareholder. Kilimnik sold the corporation's assets to Peter Suriano, the corporation's general manager. Kilimnik

changed the name of AAM to WNK Enterprises. Suriano set up a new corporation called AAM, which then purchased WNK's assets. The purchase was made through a combination of cash, assumption of trade payables, and a promissory note. Kilimnik was the president of the new AAM, and Suriano was the general manager. Suriano left the corporation. Suriano gave Kilimnik an irrevocable proxy to vote his stock, receive a payment in return, and was released from liability on the promissory note.

Initially, in August 1985, AAM made a payment on the note and redeemed preferred stock Kilimnik held. Later, Kilimnik filed notice in Washington state court to enforce his security interest. At the same time, other creditors of AAM were pressing for payments on outstanding AAM debts. Kilimnik incorporated another corporation ("Aerospace") and transferred AAM's business to the new corporation. Kilimnik informed AAM he intended to resign his position with AAM, and, after a special AAM stockholders' meeting, AAM agreed to surrender its rights to inventory, equipment, and receivables to Kilimnik in return for his agreement to forego a defi-

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ciency judgment against AAM. AAM's assets were turned over to Kilimnik.

Creditors of AAM filed an involuntary Chapter 7 proceeding against AAM, and a bankruptcy trustee was appointed. The trustee sought to recover from Kilimnik the value of the AAM assets surrendered to Kilimnik, subject to Kilimnik's claim to equitable subordination, and to impose successor liability on Aerospace. The bankruptcy court granted summary judgment in favor of Kilimnik with respect to his claim of a security interest in inventory and equipment. The court found that the August 1985 payment was preferential but dismissed the trustee's other claims. On appeal, the

district court affirmed. The trustee appealed, and Kilimnik cross-appealed.

[1] The bankruptcy court held that, when Kilimnik foreclosed, he had a valid, perfected security interest in all of AAM's equipment, inventory, and receivables. [2] In reaching this decision, the bankruptcy court relied on the plain language of the purchase agreement. [3] However, the agreement made no reference to "after-acquired" equipment or inventory. [4] Kilimnik argued that, where a creditor acquires a security interest in equipment and inventory, the court should find that this interest automatically extends to after-acquired property. Case authority on this issue is split, and [5] no Washington or Ninth Circuit cases are on point. [6] No decision on this issue is necessary in this case because the purchase agreement referred only to items on hand as of the agreement date. [7] Further, the rationale of "automatic" security interest cases does not apply to after-acquired equipment. [8] Kilimnik's security interest was limited to equipment and inventory owned by AAM on the purchase agreement, except to the extent that after-acquired inventory secured outstanding working capital advances made under the working capital security agreement.

[9] The bankruptcy court found that Kilimnik held a perfected security interest in vehicles under the purchase agree-

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ment. [10] The court erred, under Washington law. [11] On remand, Kilimnik should be ordered to pay the estate the market value of the vehicles plus interest.

[12] The evidence did not support Kilimnik's claim of right to funds in AAM's Liquid Assets Management Account. [13] A creditor bears the burden of establishing that a deposit account contains proceeds of collateral covered by a security interest. [14] Kilimnik merely testified that the account was "related to" his

security interest. [15] He did not meet his burden of rebutting a presumption against him.

[16] The bankruptcy court declined to subordinate Kilimnik's claims to those of other creditors, [17] apparently concluding that Kilimnik did not act inequitably and that there was no harm to creditors. [18] Kilimnik was an insider, and he had a fiduciary duty to AAM; [19] his actions did not withstand appropriate scrutiny. [20] Further, he placed his own interests before those of AAM. [21] The bankruptcy court found Kilimnik's conduct did no damage to creditors as a whole. [22] This focus was erroneous; the court should have focused on whether Kilimnik resulted in injury to competing claimants or unfair advantage to himself.

[23] The bankruptcy court found that Aerospace was not subject to successor liability. [24] This conclusion was in error. [25] The court should have considered whether successor liability existed on either a continuation or fraud theory. [26] The circumstances of this case indicate that Kilimnik may be liable as a successor under a fraud-to-creditors theory. [27] On remand, the bankruptcy court should consider this issue again, under both theories.

[28] The bankruptcy court held that any good will of AAM ceased when Kilimnik foreclosed on its tangible asses. [29] A strong argument can be made that the court erred, even under a clearly erroneous standard of review. [30] The court

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erred in finding no good will and in finding Kilimnik did not benefit from a fraudulent transfer of that good will.

COUNSEL

Joseph E. Shickich, Jr., Riddell, Williams, Bullitt & Walkinshaw, Seattle, Washington, for the plaintiff-appellant-

appellee.

William S. Weinstein, Weinstein, Fischer & Riley, Seattle, Washington, for the defendants-appellees-appellants.

OPINION

FLETCHER, Circuit Judge:

The trustee for debtor American Alloy Metals ("AAM") appeals the district court's affirmance of the bankruptcy court's decision in an adversary proceeding brought by the trustee against Walter Kilimnik, former president of AAM. The decision in most respects favored Kilimnik. Kilimnik cross appeals that portion of the judgment that disfavored him. We reverse in most respects and remand.

FACTS

Walter Kilimnik founded AAM in 1965. He moved the company from California to Vancouver, Washington in 1980.

In 1982, Kilimnik, AAM's president and sole shareholder, sold the assets of AAM to a corporation owned by Peter Suriano, AAM's general manager. The transaction was structured as a leveraged by-out. Kilimnik changed the name of AAM to WNK Enterprises, Inc. ("WNK"), while Suriano set up a new corporation called AAM. The new AAM purchased the

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assets of WNK. Suriano and AAM arranged to pay the purchase price as follows: Suriano made a down payment of $50,000, (the new) AAM assumed $385,000 of WNK's trade payables, and

Suriano and AAM executed a promissory note in favor of Kilimnik for $3.95 million. The nature of the collateral securing the balance of the purchase price is one of the key issues. On May 1, 1982, the parties executed an agreement for the sale of the assets of WNK ("Purchase Agreement") to AAM and Suriano. After the sale, however, Kilimnik was president of AAM, and Suriano was general manager, positions each had held in the first AAM.

Kilimnik was to receive periodic payments on the note, but payments ceased almost immediately. No payments were made between September 1982 and August 1985 (when a preferential payment was made to Kilimnik).

In the spring of 1985, Suriano and Kilimnik apparently had a falling out. After negotiations, Suriano agreed to leave the corporation. As part of the settlement, he gave Kilimnik an irrevocable proxy to vote all his stock in the corporation. AAM paid Suriano an amount roughly equivalent to his 1982 down payment, and Suriano was released from personal liability on the promissory note.

Kilimnik was in sole control of AAM as president and holder of an irrevocable proxy to vote the shares. Apparently, under his direction, AAM's business began to improve. However, it had some problems with slow pay to its trade creditors, and Kilimnik found it necessary to reassure some of them. In early July 1985, Kilimnik had a heart attack, and was hospitalized for about two weeks. At the end of July, Kilimnik leased a small office in a location a short distance from AAM.

In August 1985, AAM made a $75,000 payment on the note to Kilimnik, and also redeemed $2,000 of preferred stock he held. On August 29, 1985, Kilimnik gave AAM notice of his intention to declare default on the note on September 9,

1985. On September 13, 1985, Kilimnik filed suit in the Washington state court to enforce his security interest. During this period, AAM placed unusually large orders with several of its suppliers. The bankruptcy court found substantial payments were also made to creditors at this time, although creditors continued to press AAM for payment and even threatened legal action.

In September 1985, Kilimnik incorporated AAM Aerospace and Corrosion International, Inc. ("Aerospace").[1] Kilimnik began a transition of AAM's business to Aerospace. Aerospace took over AAM's facilities, and all AAM's employees became Aerospace employees. AAM's phone lines were moved to the small office that had been rented in July. A temporary employee was hired to answer the phone; she would take messages from AAM customers and deliver them to what was now Aerospace. Aerospace would then take the customer orders.

On September 30, 1985, Kilimnik informed AAM of his resignation as president and chairman of the board of directors, effective October 1, 1985. On October 1, a special meeting of AAM shareholders was held. A resolution was adopted directing AAM to waive its rights in its inventory, equipment and receivables and surrender them to Kilimnik, in exchange for Kilimnik's agreement to forego a deficiency judgment against AAM. AAM's assets were then turned over to Kilimnik. On October 2, 1985, Kilimnik withdrew $104,600 from an AAM deposit account.

On October 11, 1985, an involuntary chapter 7 petition was filed against AAM by certain of its creditors. In January 1986, the bankruptcy court approved the appointment of Joseph E. Shickich,

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[1] In February 1986, the new corporation officially dropped the "AAM" from the beginning of its name.

Jr. as special counsel to the trustee for AAM; Shickich was employed for the purpose of bringing an adversary

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action against Kilimnik. In February 1986, the trustee instituted the proceeding against Kilimnik, seeking, among other things, to recover the value of AAM's assets surrendered to Kilimnik, to subject Kilimnik's claim to equitable subordination, and to impose successor liability on Aerospace.

The parties filed cross motions for summary judgment on the issue of Kilimnik's security interest in AAM's assets. In May 1987, the bankruptcy court granted summary judgment in favor of Kilimnik.

In September 1988, the remaining issues were tried. The bankruptcy court found that the August 1985 payments to Kilimnik were preferential, but dismissed the trustee's remaining claims. The trustee appealed to the district court, which, without discussion, affirmed the bankruptcy court's decision in its entirety in September 1990. The trustee now appeals, and Kilimnik cross-appeals.

I

The trustee seeks recovery of the equipment, inventory and accounts receivable seized by Kilimnik in foreclosure of his claim. The trustee also seeks to recover the $104,631.79 that Kilimnik caused the debtor to withdraw from its Liquid Assets Management Account ("LAMA") and pay to himself on October 2, 1985, and the value of several motor vehicles Kilimnik transferred to himself.

[1] On the parties' cross-motions for summary judgment, the bankruptcy court held that, at the time he foreclosed, Kilimnik had a valid, perfected security interest "in all inventories, deferred charges, machinery, equipment, automobiles, office furniture and

equipment and accounts receivable" of AAM. Later, after trial, the court held that the LAMA was also subject to Kilimnik's security interest, because "the LAMA account was related to the debtor's account receiv-

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able and such receivables were subject to the Kilimnik's [sic] security interest." The trustee appeals these rulings.

Interpretation of a contract is an issue of law reviewed de novo. *Taylor-Edwards Warehouse v. Burlington Northern*, 715 F.2d 1330, 1333 (9th Cir. 1983) (applying Washington law). "Under Washington law, the role of the court in a contract action 'is to ascertain the parties' intentions and give effect to their intentions.'" *Id.* at 1334 (quoting *In re estate of Hollingsworth*, 560 P.2d 348, 350-51 (Wash. 1977)). Extrinsic evidence is admissible as to the entire circumstances under which the contract was made as an aid in ascertaining the parties' intent. *Berg v. Hudesman*, 801 P.2d 222, 229 (Wash. 1990).

Three paragraphs of the purchase agreement are relevant. Paragraph 1 describes the property sold. Paragraph 8 is captioned "Security Agreement and Collateral" and provides, in relevant part:

> To the extent Buyer create accounts receivable from sales made subsequent to closing date, Buyer agrees to allow the accounts receivable as collateral for the payments which are due or to become due under the terms of the promissory note delivered to Seller as part of the purchase price. Buyer also allows his stock certificate in American Alloy Metals, Inc. to be given as collateral for the note. Buyer and Seller agree to the terms of the Working Capital Financial Agreement attached hereto and made a part hereof, designated as Exhibit "H".

App. 12, p. A-100. Paragraph 25, captioned "UCC-1 For Sale," provides for the buyer to "execute a Form UCC-1 and to initial such additional sheets as may be required to describe the items of personal property being purchased hereunder.

[2] In reaching its decision that Kilimnik had a security interest in AAM's equipment and inventory, the bankruptcy

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court relied only on the plain language of the Purchase Agreement: "[T]he purchase and sale agreement, when read as a whole, contains a security agreement that described adequately the collateral that is the subject of this dispute." The bankruptcy court reasoned that paragraph 25 indicated that the seller was to retain a security interest in the property transferred, while paragraph 8 provided for additional collateral for the credit extended. On appeal, the trustee apparently does not contest that Kilimnik had a security interest in the equipment and inventory transferred at the time of the purchase agreement.

[3] Nonetheless, a reading of the Purchase Agreement alone does not support a holding that Kilimnik had a secured interest in equipment and inventory acquired after May 1, 1982. Indeed, the bankruptcy court does not explicitly discuss this issue in its memorandum decision, although in its order it provides that Kilimnik had "a valid security interest in all" equipment, inventory and other personal property. The Purchase Agreement makes no reference to "after-acquired" equipment or inventory, although it does use "after-acquired" language with respect to accounts receivable.

However, Paragraph 8 states that the Purchase Agreement incorporates the terms of the Working Capital Financial Agreement. That Agreement provides for AAM to grant to Kilimnik a security interest, as set forth in the security agreement appended to it ("Working Capital Security Agreement"). The Working Capital

Security Agreement gives Kilimnik a security interest "[i]n all of Debtor's inventory . . . either now or hereafter acquired." Thus, through the incorporation set out in Paragraph 8, Kilimnik would have a security interest in inventory acquired by AAM after May 1, 1982 to the extent it secured working capital advanced by Kilimnik and outstanding at the time of foreclosure. The advance of any such amounts is not reflected in the bankruptcy court's findings.

[4] Kilimnik, however, argues that, where a creditor acquires a security interest in equipment and inventory, the

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court should find that this interest automatically extends to after-acquired inventory and equipment. There is substantial support for the proposition that, where a financing statement or security agreement provides for a security interest in "all inventory" (or uses similar broad language), the document incorporates after-acquired inventory. The rationale is that inventory is constantly turning over, and no creditor could reasonably agree to be secured by an asset that would vanish in a short time in the normal course of business. *See, e.g., American Employers Ins. Co. v. American Sec. Bank*, 747 F.2d 1493, 1501 (D.C. Cir. 1984); *National Bank v. West Tex. Wholesale Supply Co. (In re McBee)*, 714 F.2d 1316, 1331 (5th Cir. 1983) (applying Texas law); *In re Nickerson & Nickerson, Inc.*, 329 F. Supp. 93, 96 (D. Neb.), *aff'd*, 452 F.2d 56 (8th Cir. 1971); *In re Fibre Glass Boat Corp.*, 324 F. Supp. 1054, 1056 (S.D. Fla.), *aff'd*, 448 F.2d 781 (5th Cir. 1971); *In re Kelton Motors, Inc.*, 117 B.R. 87, 90-91 (Bankr. D. Vt. 1990) (financing statement; applying Vermont law) *rev'd on other grounds*, 135 B.R. 758 (D. Vt. 1991); *In re American Family Marketing Corp.*, 92 B.R. 952, 954 (Bankr. M.D. Fla. 1988) (financing statement; applying Florida law); *Sims Office Supply v. KA-D-KA, Inc. (In re Sims Office Supply)*, 83 B.R. 69 (Bankr. M.D. Fla. 1988) (security agreement) ("a provision for after-acquired property is to be automatically presumed unless there is some indication that the parties intended a different result"). The

position that no express language is required is described as the "majority" view, *American Family Marketing*, 92 B.R. at 953, or the "modern trend." *Sims Office Supply*, 83 B.R. at 72. There is, however, contrary authority, which reasons that "the [UCC] contemplates that a security agreement should clearly spell out any claims to after acquired collateral." *Covey v. First Nat'l Bank (In re Balcain Equip. Co., Inc.)*, 80 B.R. 461, 462 (Bankr. C.D. Ill. 1987); *see also In re Middle Atl. Stud Welding Co.*, 503 F.2d 1133, 1135 (3d Cir. 1974).

[5] No Washington or Ninth Circuit cases appear to be directly on point. The trustee cites *Dubay v. Williams*, 417

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F.2d 1277, 1285 (9th Cir. 1969), as holding that express language is required to create an interest in after-acquired property. However, that case does not go quite so far. At issue in *DuBay* was the creditor's security interest in certain accounts receivable. The security agreement provided for the creditor to select, at given times, accounts to serve as security for his loan. The creditor argued that the designation of these accounts created a security interest "not only in respect of their then stated balances, but also of the future balances of those accounts" which were not later released from the security agreement. The court rejected this argument: "The contention fails because those instruments do not contain any words which import an intention to give a security interest in after-acquired property and the language used is not consistent with such an intent." 417 F.2d at 1285. The court added, "The parties intended any future accounts and balances to be added by later assignments; there was no intent presently to assign future balances in those accounts. It is obvious that the parties did not draft the agreement and the assignment with the provisions of the Commercial Code in mind." *Id.* In *DuBay*, then, the court found that the parties' agreement contemplated an arrangement very different from the usual Article 9 agreement. We do not read the case as establishing the

requirements for an Article 9 security agreement or financing statement.[2]

[6] We conclude that we need not decide whether to adopt

the "majority" view in this case since the Purchase Agreement does not contain the usual language granting a security interest in "all inventory" or "inventory," but only in the items specifically described in paragraph 1 as "inventory ... on hand at May 1, 1982."

[7] In addition, the rationale of the "automatic" security interest cases does not apply to after-acquired equipment. Those cases discuss cyclically depleted and replenished assets such as inventory or accounts receivable. Unlike inventory, equipment is not normally subject to frequent turnover.[3]

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[2] The two other Ninth Circuit cases the parties cite are also not especially helpful. The trustee views *Northwest Acceptance Corp. v. Lynnwood Equip., Inc.*, 841-F.2d 918 (9th Cir. 1988), as decisive in his favor. However, that case merely held that, where the financing statement and the security agreement differ as to the collateral covered, the security agreement defines "the extent of the security interest." 841 F.2d at 922. That is not the issue here. Kilimnik relies on *Biggins v. Southwest Bank*, 490 F.2d 1304 (9th Cir. 1973). At issue there was whether the description in a financing statement adequately put creditors on notice of the security holder's interest. 490 F.2d at 1308-1309. The case also discusses the general validity of floating liens. *Id.* at 1309-1310.

[3] Kilimnik also argues that he has a security agreement in after-acquired inventory and equipment because they must be proceeds of the accounts receivable in which he has a security interest. However, Wash. Rev. Code §62A.9-306(2) provides that a creditor's security interest "continues in any identifiable proceeds." Kilimnik has not introduced evidence to identify the assets he claims as proceeds of his collateral.

We are aware that the financing statement mentions after acquired equipment, suggesting that the parties intended Kilimnik's security interest would extend this far. Yet we must look to the entire circumstances under which the purchase agreement was made to ascertain its meaning. *See Berg*, 801 P.2d at 229. Under Washington law, a contract is interpreted by reference to many contextual factors, including the subject matter of the transaction, the subsequent conduct of the parties and the reasonableness of their interpretations. *See id.*

The trustee here advances the more reasonable interpretation: Kilimnik took a kind of "purchase money" interest in the equipment he sold to AAM, but he did not get the additional security of a blanket interest in all equipment the company ever acquired after the sale. The subject matter of the transaction also supports this conclusion.

Kilimnik would not have had a clear reason to want after-

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acquired equipment covered by the purchase agreement. As we have seen, equipment, unlike inventory, is not normally subject to frequent turnover. Even if limited to the equipment on hand at the time of sale, his interest would have been secure.

[8] In summary, we conclude that Kilimnik's security interest was limited to equipment and inventory owned by AAM on May 1, 1982 except tot he extent that after-acquired inventory secured outstanding working capital advances made under the working capital security agreement. This conclusion necessitates a remand to the bankruptcy court for determination of the value of the improperly seized collateral, and for further findings on whether Kilimnik received a preference. *See* 11 U.S.C. §547 (trustee can "avoid" (recover for the bankruptcy estate) any "preferential" transfer of the debtor's property, made to satisfy an antecedent debt, while the

debtor was insolvent, within 90 days before the filing of a bankruptcy petition, and which allows the creditor to receive more than it would otherwise receive under the debtor's liquidation or reorganization plan).

II

On October 11, 1985, after AAM filed its bankruptcy petition, Kilimnik transferred three of AAM's motor vehicles into his own name, although he was not the registered or legal owner of any of them. The trustee contended the vehicles were property of the estate and should be returned, under 11 U.S.C. §542 (turnover of property to the estate).

[9] The bankruptcy court held that Kilimnik held a perfected security interest in the vehicles pursuant to the Purchase Agreement and the October 6, 1982 UCC-1.

[10] The bankruptcy court erred. Under Washington law, a security interest in a motor vehicle is perfected by notation of

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the secured party's name on the vehicle's certificate of ownership, not by filing a UCC-1. Wash. Rev. Code §46.12.095.

Kilimnik does not seriously contest this point, but rather contends the trustee failed to prove that seizure of the vehicles was a preferential transfer and that "these old fuel-inefficient vehicles had a market value in excess of the costs of seizing and selling them." Kilimnik is correct that, in determining whether gaining title of the vehicles constituted a preferential transfer to him, the court must "focus on value in the hands of the creditor." *Smith v. Associates Commercial Corp. (In re Clark Pipe and Supply Co., Inc.)*, 893 F.2d 693, 698 (5th Cir. 1990). However, here Kilimnik did not realize value from the vehicles by selling them and

applying the proceeds to reduce his debt, but rather by putting them into use at Aerospace. Thus, liquidation costs should not be deducted from the market value.

[11] In any case, the trustee seeks recovery not on the theory that the transfer was preferential, but rather on the theory that Kilimnik's action was illegal because he had no legal right to the vehicles. *See Sherwood v. Bellevue Dodge, Inc.* 669 P.2d 1258, 1262 (Wash. Ct. App. 1983) (where creditor does not have a perfected security interest or contractual right to foreclose, nonjudicial repossession of vehicle constitutes "unlawful conversion"). Thus, on remand Kilimnik should be ordered to pay to the estate the market value of the vehicles at the time of transfer, plus interest.

III

Generally, bank accounts are outside the scope of Article 9 of the UCC. Wash. Rev. Code §62A.9-104(l) (Article 9 does not cover "any deposit account"). However, a creditor's security interest may extend to any or all funds in a deposit account where the funds are "proceeds" of collateral covered by a security interest. Wash. Rev. Code §62A.9-306. Section 9-306(4) determines the extent of the security interest where

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the borrower has filed for bankruptcy; it provides, in relevant part:

> In the event of insolvency proceedings instituted by or against a debtor, a secured party with a perfected security interest in proceeds has a perfected security interest only in the following proceeds:
>
> (a) in identifiable non-cash proceeds and in separate deposit accounts containing only proceeds

> [...]
>
> (d) in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, but the perfected security interest under this paragraph (d) is:
>
> [...]
>
> limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings less the sum of (I) the payments to the secured party on account of cash proceeds received by the debtor during such period and (II) the cash proceeds received by the debtor during such period to which the secured party is entitled under paragraphs (a) through (c) of this subsection (4).

Wash. Rev. Code §62A.9-306(4).

[12] Before the bankruptcy court, Kilimnik testified that the LAMA was "related to accounts receivable" and "related to the UCC filing as my security." However, apparently he submitted no documentary evidence, nor did he provide further testimony, as to the source of the funds in the LAMA. We

conclude as a matter of law that this evidence was inadequate to establish Kilimnik's right to the funds in the account.

[13] This court has held that the creditor bears the burden of establishing that a deposit account contains proceeds of collateral covered by a security interest.

> The creditor's security interest in the whole account under Section 9-306(4) is *prima facie* valid, except

> as to the trustee, and, as to him, the creditor's security interest is presumptively preferential. The creditor can rebut the presumption by appropriately tracing his proceeds. We think that it is fair to place the burden on the creditor to identify his own proceeds and thus to defeat in whole or in part, the trustee's claim of preference.

Arizona Wholesale Supply Co. v. Itule (In re Gibson Products), 543 F.2d 652 (9th Cir. 1976), *cert. denied*, 430 U.S. 946 (1977); *see also Maxl Sales Co. v. Critiques, Inc.*, 796 F.2d 1293, 1301 (10th Cir. 1986) (creditor who failed to present evidence on amount of proceeds received by debtor could not establish right to funds in account); *United States v. Barsotti Bros. Bakery*, 80 B.R. 745, 749 (Bankr. W.D. Pa. 1987) (Dismissing claim of creditor who failed to meet burden of proving account contained only proceeds); *Charter First Mortgage v. Oregon Bank (In re Charter First Mortgage)*, 56 B.R. 838, 850 (Bankr. D. Ore. 1985) (creditor failed to show debtor received proceeds during 10 day period preceding filing).

Courts have generally required the creditor to submit detailed documentary evidence, or testimony proving that an account contained only proceeds, or establishing the amount of proceeds the debtor received in the ten days preceding the bankruptcy filing. For example, in *In re Mark Twain Marine Indus., Inc.*, 115 B.R. 948, 953 (Bankr. N.D. Ill. 1990), the court held that a creditor had failed to meet its burden.

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Although the debtor had submitted the bank statement of the account at issue, the creditor did not provide "any evidence of what any of the remittances [deposited into the account] were for." The court refused to "speculate" that the deposits were proceeds of the creditor's collateral.

[14] Here, Kilimnik merely testified that the LAMA was "related to" his security interest. He did not even state that the LAMA contained only proceeds (to establish his rights under section 9-306(4)(a)), nor did he state that, in the ten days preceding its filing, AAM had received proceeds in at least the amount he withdrew (to establish his rights under section 9-306(4)(d)). Moreover, cases suggest that mere "self-serving" testimony such as Kilimnik's is inadequate. *Barsotti Bros. Bakery*, 80 B.R. at 748. Section 9-306 "require[s] the creditor to bird-dog his proceeds or pay the consequences." *Charter First Mortgage*, 56 B.R. at 851. Because he controlled AAM, Kilimnik could easily have instituted proper procedures to keep track of the proceeds of his collateral; moreover, he would be aware of the type of documentation available at AAM to substantiate his claim before the court.

[15] Kilimnik argues that the trustee has submitted no evidence to controvert Kilimnik's "evidence." However, at issue here is whether Kilimnik has met his initial burden of rebutting the presumption against him. He has not done so. We reverse the bankruptcy court on this issue and direct that on remand Kilimnik be ordered to pay to the trustee the amount taken from the LAMA, plus interest from the date of taking.

IV

[16] The trustee asked the court equitably to subordinate Kilimnik's claims to those of the other creditors. The bankruptcy court declined to do so.

The bankruptcy court's decision on the issue of equitable subordination is reviewed for abuse of discretion. *Spacek v.*

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Thomen (In re Universal Farming Indus.), 873 F.2d 1334, 1337 (9th Cir. 1989). "Equitable subordination requires that: (1) the claimant who is to be subordinated has engaged in inequitable conduct; (2) the

misconduct results in injury to competing claimants or an unfair advantage to the claimant to be subordinated; and (3) subordination is not inconsistent with bankruptcy law." *Id.*; *See also Christian Ctr. Life Litig. Defense Comm. v. Silva (In re Christian Life Center)*, 821 F. 2d 1370, 1376 (9th Cir. 1987) ("The bankruptcy court may subordinate a claim if it finds the claimant engaged in fraud unfairness or inequity and the claimant's conduct harmed the debtor or its other creditors.") When the trustee seeks to subordinate the claim of a creditor the trustee must present evidence of the creditor's unfair conduct. If the trustee meets this burden, "the claimant then must prove the fairness of his transactions with the debtor or his claim will be subordinated." *Estes v. N & D Properties, Inc. (In re N & D Properties)*, 799 F.2d 726, 731 (11th Cir. 1986); *see also Christian Life Ctr.* 821 F.2d at 1377.

In support of its decision not to subordinate Kilimnik's claims, the bankruptcy court stated:

> On this record, it would appear to me that where a secured creditor properly foreclosed a security agreement, that no duty to other creditors and/or to the corporation to continue it in existence as a going business remained. Even if there was a technical breach by Mr. Kilimnik in that he controlled both American Alloy Metals and ACI [Aerospace], or that he intended to set up ACI after the foreclosure, there was no damage to the creditors as a whole.
>
> Certainly there was benefit, on this record, to Mr. Kilimnik by his actions, in that he had the benefit of essentially putting in ACI as a going corporation; but I find no corresponding detriment or injury to the creditors as a whole.
>
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ER at 285-86. The bankruptcy court issued this ruling orally; it did not revisit the issue in the conclusions of law it later propounded.

[17] The bankruptcy court apparently concluded that neither the first nor the second factor necessary for equitable subordination was present: Kilimnik had not acted inequitably; nor was there any harm to creditors. On appeal, the trustee contends that both requirements were met.

A. Inequitable conduct

The bankruptcy court's ruling suggests it concluded that because he was merely a secured creditor, Kilimnik owed no fiduciary duty to the other creditors and thus cannot be found to have acted inequitably. It is difficult to square this analysis with precedent on the issue of equitable subordination.

Case law suggests that whether or not Kilimnik's claim was secured is irrelevant to this issue. *See, e.g., Fabricators, Inc. v. Technical Fabricators, Inc. (In re Fabricators, Inc.)*, 926 F.2d 1458 (5th Cir. 1991) (subordinating secured claim). Rather, the equitable subordination inquiry focuses on the conduct of the claimant at issue, and the nature of its relationship to the debtor.

[18] Under the bankruptcy code, Kilimnik was an insider of the debtor. The bankruptcy court found, "In May of 1985, Mr. Kilimnik came back into control of [AAM]; and from that date until the involuntary bankruptcy petition, he did control the corporation, either as president, a member of the board of directors, or the controlling shareholder." The record suggests that the finding should have gone further: Mr. Kilimnik never relinquished operating control. He was president of AAM from the moment it acquired the assets from WNK. A "person in control of the debtor" is an "insider" of the debtor. 11 USC §101(31). When the trustee seeks to subordinate "a claim arising from the dealings between a debtor and an

insider," the court will give the insider's actions rigorous scrutiny. *Fabricators*, 926 F.2d at 1465. Moreover, Kilimnik had a fiduciary duty to AAM. *See Pepper v. Litton*, 308 U.S. 295, 306 (1939) ("dominant or controlling stockholder" is a fiduciary); *Washington v. Keypoint Oyster Co.*, 391 P.2d 979, 983 (Wash. 1964) (corporate officers and directors have a fiduciary relation to the corporation). The "standard of fiduciary obligation is designed for the protection of the entire community of interests in the corporation - creditors as well as stockholders." *Pepper*, 308 U.S. at 307 (footnote omitted).

[19] Here, the bankruptcy court's own findings suggest Kilimnik's actions could not withstand this rigorous scrutiny. As a secured creditor whose loan was in default, Kilimnik was entitled to foreclose, but, as president, controlling shareholder and director, he participated in the vote by AAM's board to waive its rights in the collateral. Admittedly AAM was thereby released from liability for the amount by which Kilimnik's claim exceeded the value of the collateral, but that does not cure the problem. The court expressly found that "[i]n foreclosing on his note, opening AAM Aerospace & Corrosion International and having Debtor renounce its interest in collateral, Kilimnik intended, if possible, to place his own interest, which he believed to be secured, ahead of the interests of Debtor's creditors."

[20] In addition, Kilimnik's other actions in the months preceding foreclosure demonstrate that he placed his own interests before those of AAM, and acted to the detriment of other creditors. The bankruptcy court found that, by September 1985, Kilimnik "had determined to start a new corporation which would compete directly with [AAM], if it continued to exist." The court also made findings that suggest that for some time Kilimnik operated AAM in such a way as to prepare for Aerospace to take over its business (he rented separate additional office space at the end of July 1985). The

bankruptcy court found that there was evidence to suggest that Kilimnik had not purposely increased inventories or built

up trade debt before he foreclosed on the AAM assets; however, the court also noted that AAM, while under Kilimnik's control, had made somewhat larger purchases from its suppliers, and that Kilimnik had made assurances to AAM's suppliers to persuade them to continue to do business with AAM. *Cf. Fabricators,* 926 F.2d at 1467 (insider creditor acted inequitably when it induced other creditors to extend credit to debtor, where insider knew debtor was in financial trouble).

B. Injury to competing claimants

[21] The bankruptcy court found that Kilimnik's conduct had caused "no damage to the creditors as a whole."[4] It apparently reached the conclusion that there had been no damage because it had determined that Kilimnik, as a secured creditor, was entitled to foreclose. Because his claim had priority over the unsecured claims of the suppliers, his actions did not damage them. Moreover, the court found that AAM had made substantial payments to creditors in the months preceding Kilimnik's foreclosure and AAM's filing of a chapter 11 claim.

[22] We conclude the bankruptcy court erroneously focused on the harm to "creditors as a whole." The proper inquiry was whether Kilimnik's self-dealing resulted in "injury to competing claimants or an unfair advantage" to Kilimnik himself. A claim will be subordinated only to the claims of creditors whom the inequitable conduct has disadvantaged. *Fabricators*, 926 F.2d at 1470; *N & D Properties*, 799 F.2d at 733. Thus, the bankruptcy court should have looked at the harm to each of the relevant creditors to determine whether Kilimnik's claim should be subordinated to their

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[4]The court later clarified this ruling, stating that it was referring to "any and all creditors of [AAM] between May-October 1985" rather than to "the creditors in this bankruptcy estate." ER 255.

claims and, if so, to what extent. The bankruptcy court's findings here suggest that Kilimnik's conduct may have

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injured several trade creditors. After Kilimnik was in complete control of AAM, AAM made larger than normal purchases from certain suppliers; this suggests Kilimnik was building up inventory in preparation for foreclosure. In addition, the court's findings suggest that reassurances by Kilimnik induced Cabot Corporation to continue supplying AAM and to postpone efforts to collect on past due debt.[5]

C. Conclusion

We reverse the bankruptcy court's holding that Kilimnik's claim should not be equitably subordinated. We conclude that all three requirements for equitable subordination have been met, and that Kilimnik's claim should be subordinated to the claims of any named creditors. [6] On remand, the bankruptcy

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[5]Kilimnik contends that the trade creditors have suffered no injury because any harm to them "merely flowed from their status as junior unsecured creditors." This is incorrect; at issue is whether Kilimnik's inequitable conduct harmed the trade creditors by, for example, inducing them to ship goods to AAM when there was little likelihood they would be paid. Kilimnik cites *Spacek v. Thomen (In re Universal Farming Industries)*, 873 F.2d 1334, 1337 (9th Cir. 1989), but that case is distinguishable. There, this court held that a creditor did not act inequitably by acquiring an admittedly valid trust deed from a third party. Another creditor contended that this act created a risk that he would not be paid. This court concluded that such a risk arose from the latter creditor's status as a junior lienholder, the trust deed holder's misconduct, if any, did not create that risk. Here, the trustee is alleging that Kilimnik's misconduct while an insider of AAM directly harmed the trade creditors.

[6]Kilimnik appears to suggest that equitable subordination would be inconsistent with the goals of bankruptcy law, because to do so would discourage corporate insiders from using their best efforts to turn around a struggling business. He cites *Benjamin v. Diamond (In re Mobile Steel)*, 563 F.2d 692, 701 (5th Cir. 1977), in which the court refused to require fiduciaries to "prove the good faith and fairness of every one of their actions with respect to their corporation" because such a burden would "discourage those most interested in a corporation from attempting to salvage it through an infusion of capital." *See also 3 Collier on Bankruptcy* §510.05 at 510-14 (Lawrence P. King ed., 15th ed. 1993) ("lawful claims of insiders are not automatically subordinated" because "such persons are the ones most interested in restoring

court must determine to which claims Kilimnik's claim should be subordinated, and to what extent.

V.

[23] The trustee also contends that Aerospace was liable for the debts of AAM as a "successor corporation." The bankruptcy court held that Aerospace was not subject to successor liability.

The Washington Supreme Court set out the principles of successor liability in *Martin v. Abbott Laboratories*, 689 P.2d 368 (Wash. 1984):

> Traditionally, a corporation purchasing the assets of another corporation does not, by reason of the purchase of assets, become liable for the debts and liabilities of the selling corporation. The courts have recognized, however, that the traditional rule allows a transferring corporation, under certain circumstances, to effectively avoid its obligations to the detriment of *creditors* and minority *shareholders*. Thus, Washington has recognized four narrow exceptions to the traditional rule: (1) the purchaser expressly or impliedly agrees to assume liability; (2) the purchase is a *de facto* merger or consolidation; (3) the purchaser is a mere continuation of the seller; or (4) the transfer of assets is for the fraudulent purpose of escaping liability.

689 P.2d at 384

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and reviving" the debtor). However, Kilimnik's action suggest that his goal was not to "revive" AAM, but rather to give Aerospace a good start.

The bankruptcy court found: "Since AAM Aerospace & Corrosion International did not purchase the Debtor's assets form the Debtor, AAM Aerospace & Corrosion International did not become a successor corporation to the Debtor and is not subject to successor liability."

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[24] The bankruptcy court erred in this conclusion. While the Washington Supreme Court's formulation of the successor liability test refers to a "purchase" of assets, its discussion also suggests that other forms of "transfer" of assets may result in such liability. We conclude that the Washington court would extend liability to transfers other than straightforward purchases. Otherwise, unscrupulous business persons would be able to avoid successor liability and cheat creditors merely by changing the form of the transfer. Several states have explicitly included the phrase "or otherwise transfers" in their formulation of the law. *See, e.g. Florom v. Elliott Mfg.*, 867 F.2d 570, 575 (10th Cir. 1989) (Colorado law) (discussing exception to general rule of nonliability of successor corporations where "predecessor sells or otherwise transfers all its assets to the successor ... "); *Wallace v. Dorsey Trailers Southeast, Inc.*, 849 F.2d 341, 343 (8th Cir. 1988) (Missouri law) ("Where one corporation sells or otherwise transfers *all* of its assets to another corporation ... ") (emphasis original; citation omitted). Fletcher's *Cyclopedia of Corporations* also suggest that successor liability is not limited to transactions in which the asset transfer is accomplished through purchase. *See* 15 William M. Fletcher, *Fletcher Cyclopedia of the Law of Private Corporations* §7122 (perm. ed. rev. vol. 1990).

[25] The bankruptcy court should have considered whether successor liability existed on either a continuation or a fraud theory.

Kilimnik argues that Aerospace falls within the secured creditor exception to the mere continuation theory. In *Uni-Com*

Northwest Ltd. v. Argus Publishing Co., 737 P.2d 304 (Wash. Ct. App.), *review denied*, 108 Wash. 2d 1032 (1987), the court noted that where a secured creditor "tak[es] over an insolvent debtor to collect a bona fide debt pursuant to a valid, perfected security interest," there was no successor liability under the mere continuation theory. 737 P.2d at 313.

However, the *Uni-Com* discussion of successor liability also suggests that Aerospace may nonetheless be liable. In

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reaching it conclusion, the *Uni-Com* court distinguished certain cases because in them the creditor did not have a perfected security interest. It also noted that "none of [the distinguished cases] involve a creditor such as MPC who has substantial business interests in addition to those of the business assumed." The *Uni-Com* court cited, in contrast to the case before it, two cases in which successor liability had been found: *Bishop v. Dura-Lite Mfg. Co.*, 489 F.2d 710 (6th Cir. 1973), in which a new corporation was formed specifically to take over the debtor corporation in order that the debtor corporation could escape liability, and *Brockmann v. O'Neill*, 565 S.W. 2d 796 (Mo. Ct. App. 1978), in which a new corporation was formed after the debtor corporation ceased doing business, and the new corporation completely took over all contracts of the seller, using the same work force, supervisors, trucks, tools and equipment. The facts in this case very closely resemble *Bishop* and *Brockmann:* Aerospace's sole business interest was the operation it assumed from AAM; Aerospace took over AAM's set up virtually without change; AAM was left with substantial liabilities and no assets. The mere fact that the transfer of assets involved foreclosure on a security interest will not insulate a successor corporation from liability where other facts point to continuation. In *Allied Indus. Int'l, Inc. v. Agfa-Gevaert, Inc.*, 688 F. Supp. 1516 (S.D. Fla. 1988), *aff'd*, 900 F.2d 264 (11th Cir. 1990), a case the trustee cites, the court found that a new corporation set up by the president of the old corporation to

avoid payment of a judgment was subject to successor liability; all the equipment the new corporation used had belonged to the old one, until the president repossessed it in foreclosure of notes from the corporation to him. The similarity to the facts here is remarkable.

In determining whether successor liability exists under the mere continuation theory, the court looks at two factors: common identity of the officers, directors and stockholders in the two companies, and sufficiency of consideration running to the seller corporation in light of the assets sold. *Cashar v.*

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Redford, 624 P.2d 194, 196 (Wash. Ct. App. 1981). The first factor clearly is met here: Kilimnik was the controlling force in both companies. The second, however, is more complicated to analyze, as the "consideration" AAM received consisted of fulfillment of its obligation to Kilimnik through foreclosure and Kilimnik's renunciation of a deficiency judgment. Arguably, had Kilimnik had a good security interest in everything transferred there would have been adequate consideration. Any existing good will at the time Kilimnik seized AAM's assets also would affect the adequacy of the consideration. Kilimnik to some extent "paid" for the assets, but there was no payment for the employee base, customer relations and other intangible assets.

Because we conclude that successor liability may exist based on the fraud-to-creditor theory, at this juncture we need not decide the extent and adequacy of the consideration and the bankruptcy court may not need to do so on remand.

[26] The circumstances of this case indicate that Kilimnik may be liable as a successor under a fraud-to-creditors theory. When Kilimnik took with him all AAM's assets and employees, he left AAM with substantial liabilities. The bankruptcy court found that substantial payments had been made to creditors during the 90

days before the bankruptcy filing; nonetheless, sufficient claims remained to give rise to an involuntary bankruptcy petition. In addition, the bankruptcy court found that in the months just prior to Kilimnik's foreclosure, AAM had made larger purchases than was customary from its suppliers, and had not paid for them.

[27] We reverse the bankruptcy court's finding that Aerospace was not a successor to AAM. On remand the bankruptcy court should address the issue again, examining whether Kilimnik is liable first under a fraud-on-the-creditors theory and then, if necessary, under the mere continuation theory.

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VI

[28] As a separate matter, the trustee contends that Kilimnik owes the estate for the value of AAM's good will which he improperly took in 1985. The bankruptcy court held that the good will, if any, of AAM ceased to exist when Kilimnik foreclosed on its tangible assets:

> On the record, it would appear to me that once the tangible assets of American Alloy Metals were taken, no good will existed or remained, even assuming that any existed at any time.
>
> The good will, under Mr. Wheeler's testimony and the theory advanced by the trustee, was dependent on the existence of operating assets; facilities; suppliers; customer base; and management, including Mr. Kilimnik or his equivalent replacement.
>
> When the security interest was foreclosed, the good will-again, I am assuming it existed, without so finding-

> ceased to exist, based solely on the taking or the imminent taking of the tangible assets.
>
> On this record, there was not a taking of intangibles improperly by the defendant; it just ceased to exist, under Mr. Wheeler's testimony, once the taking of those assets became imminent.

ER 283.

Washington courts have defined good will as the tangible "capital" a business builds up over time:

> The good will of a going business is an element which inheres in it and cannot be separated from the whole. There are many elements, defined in the decision of this court and other jurisdictions, which
>
> [Page 2163]
>
> comprise good will. Among these are continuity of name, location, reputation for honesty and fair dealing, individual talents and ability of the members of the going business organization, and many others. Good will is an intangible element that inheres in the value of a going business.

In re Estate of Gland, 356 P.2d 707, 709 (Wash. 1960).

The bankruptcy court heard testimony that AAM had no going concern value in the fall of 1985. Ralph Arnold testified that the business had suffered such a steep decline that "the negatives were much greater than any positives which you might find." Rep.'s Tr. 1063. There was thus evidence to support the bankruptcy court's finding that no good will existed.

[29] However, there is a strong argument to be made that the bankruptcy court erred, even under the "clearly erroneous" standard

of review applicable to this factual finding. First, as the Washington Supreme Court's discussion of good will makes clear, elements of good will exist independent of a company's tangible assets. In addition, the bankruptcy court focused only on the time at which AAM's assets were seized; however, the code's fraudulent transfer provisions allow recovery of any interest transferred within one year of the filing of the petition. 11 U.S.C. §548. Moreover, the circumstances surrounding the demise of AAM suggest that Kilimnik recognized that AAM had a going concern value and took steps to misappropriate that value, even before he foreclosed on its assets. He incorporated the similarly named "AAM Aerospace," set up an arrangement under which AAM became a mere shell and caused its customers' inquires to be forwarded to the new company, and "took over" AAM's plant and employees. Thus, the bankruptcy court ignored substantial evidence that Kilimnik was attempt-

[Page 2164]

ing to take over AAM's tangible assets before he took possession of its equipment and inventory.[7]

[30] We conclude that the bankruptcy court erred in finding that AAM had no good will, and that Kilimnik did not benefit from a fraudulent transfer of that good will.

---

[7]This case closely resembles *Freehling v. Nielson (In re F & C Servs., Inc.)*, 44 B.R. 863 (Bankr. S.D. Fla. 1984). There, the president of an insurance agency set up a new agency, to which he shifted all the accounts of the old agency, while leaving the debts of the operation with the old agency. The old agency subsequently sought bankruptcy protection. The court held that the old agency's "book of business" had been fraudulently transferred to the new agency. 44 B.R. at 870-71. Kilimnik contents that this case is inapposite because it "involved a clearly fraudulent transfer where the debtor's Chairman of the Board secretly operating the company to strip its assets, sequester them in another corporation, and leave the ever-increasing debts in the former corporation's empty shell." Respondent's Br. 39. However, that seems to be just what Kilimnik did here.

VII

Kilimnik raises several issues on cross-appeal. First he challenges the appointment of Joseph Shickich as special counsel because of a conflict of interest. The bankruptcy court approved the employment of Shickich as special counsel to the trustee to prosecute the preference actions against Kilimnik. Kilimnik contends that the bankruptcy court should have disqualified Shickich from employment by the trustee because Shickich had represented Cabot Corporation, one of the creditors that had filed the involuntary petition against AAM and a competitor of Aerospace.

Section 327 governs the trustee's employment of professionals; it provides in relevant part:

> (a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys . . . that do not hold or represent
>
> [Page 2165]
>
> an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.
>
> (c) In a case under chapter 7, 12, or 11 of this title, a person is not disqualified for employment under this section solely because of such person's employment by or representation of a creditor, unless there is objection by another creditor or the United States trustee, in which case the court shall disapprove such employment if there is an actual conflict of interest.
>
> (e) The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, an attorney that has

> represented the debtor, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

11 U.S.C. § 327.

Kilimnik contends, first, that the district court failed to make the requisite findings under 327(c). The court adopted Shickich's proposed order of appointment; however, it changed the suggested language finding no "actual conflict of interest under Section 327(c)" to no "material conflict of interest under Section 327(c)." Thus, Kilimnik contends the court applied an incorrect legal standard, and the order of appointment should be reversed and remanded.

Section 327(c) allows the appointment of counsel to represent the trustee, even where counsel represents a creditor, where the court finds no "actual conflict of interest." Reasoning by analogy to section 327(e), several courts have held that, where the trustee seeks to appoint counsel only as "special counsel" for a specific matter, there need only be no

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conflict between the trustee and counsel's creditor client with respect to the specific matter itself. *Fondiller v. Robertson (In re Fondiller)*, 15 B.R. 890, 892 (Bankr. 9th Cir. 1981), *appeal dismissed*, 707 F.2d 441 (9th Cir. 1983); *see also Altenberg v. Schiffer (In re Sally Shops, Inc.)*, 50 B.R. 264, 266 (Bankr. E.D. Pa. 1985) (following *Fondiller*). Here, with respect to the Kilimnik preference action, the interests of Cabot and the trustee coincide: if money is recovered for the estate, Cabot's pro rata recovery will ultimately be greater.

Kilimnik makes a complex argument that Cabot's interests are adverse to the trustee. He suggests that the trustee is the fiduciary representative of all the creditors, including Kilimnik.

Thus, the trustee cannot let one creditor, Cabot, "seize assets foreclosed on by Kilimnik"; moreover, the trustee cannot further an action by Cabot against Aerospace, a competitor. This argument has no merit. It is the trustee who is seeking to recover a preference from Kilimnik. Under Kilimnik's reasoning, the trustee could never pursue an action against one of the estate's creditors, because he would have a fiduciary obligation to the creditor. In addition, the trustee has no obligation to protect Aerospace's interests as a competitor in its field. We conclude the appointment of Shickich was proper.

Next, Kilimnik challenges the holding that the redemption of his $2000 preferred stock constitutes a preferential transfer. On or about August 23, 1985, AAM paid Kilimnik $2,000 for redemption of 2,000 shares of preferred stock issued to him in May 1985 for services to the corporation. The bankruptcy court found that this payment constituted a preferential transfer, and ordered Kilimnik to return the funds to the trustee. Kilimnik contents that the bankruptcy court erred, because the redemption of preferred stock was not a payment "for or on account of an antecedent debt." *See* 11 U.S.C. § 547(b)(2).

The trustee relies on *Consove v. Cohen (In re Roco Corp.)*, 15 B.R. 813 (Bankr. D. R.I. 1981), *aff'd in relevant part and*

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vacated in part, 21 B.R. 429 (Bankr. 1st Cir. 1982), *aff'd*, 701 F.2d 978 (1st Cir. 1983). The relevant issue in that case, however, was whether payments made in redemption of stock constituted a fraudulent transfer. *Id.* at 816-17. The opinion spoke to preferential payments but only in the context of loan repayments. *Id.* at 817-19.

Insofar as the bankruptcy court relied on the preferential transfer theory, it is reversed. The facts here suggest that the trustee

should be able to recover on the fraudulent transfer theory, however, and on remand may be able to sustain the judgment on that basis.

CONCLUSION

The judgment of the district court affirming without comment the decision of the bankruptcy court is REVERSED in most respects and the case REMANDED to the district court for remand to the bankruptcy court for further proceedings consistent with this opinion.

APPENDIX 10

United States Court of Appeals
for the Ninth Circuit

ZACHARY STOUMBOS, Plaintiff-Appellant v. WALTER KILIMNIK, et al., Defendant-Appellee,
No. 91-35524

ZACHARY STOUMBOS, Plaintiff-Appellant/Cross-Appellee v. WALTER KILIMNIK, et al., Defendant-Appellee/Cross Appellant
No. 91-35525

Order

March 9, 1993

APPEAL FROM the United States District Court for the Western District of Washington (Tacoma).

[Page 2]

THIS CAUSE came on to be heard on the Transcript of the Record from the United States District Court for the Western District of Washington (Tacoma) and was duly submitted.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and hereby is REVERSED in most respects and the case REMANDED to the district court for remand to the bankruptcy court for further proceedings consistent with this opinion.

Filed and entered: 03/09/93

APPENDIX 11

United States Court of Appeals
for the Ninth Circuit

ZACHARY STOUMBOS, Plaintiff-Appellant v. WALTER KILIMNIK, et al., Defendant-Appellee,
No. 91-35524

ZACHARY STOUMBOS, Plaintiff-Appellant/Cross-Appellee v. WALTER KILIMNIK, et al., Defendant-Appellee/Cross Appellant
No. 91-35525

Order

April 30, 1993

Before: WRIGHT, FLETCHER and CANBY, Circuit Judges

Appellees' petition for rehearing is denied.

APPENDIX 12

Agreement for Sale of Assets of WNK Enterprises, Inc., Formerly Known as American Alloy Metals, Inc., dated May 1, 1982.

THIS AGREEMENT is made May 1, 1982, by and between WNK ENTERPRISES, INC., a Washington corporation, formerly known as American Alloy Metals, Inc., hereinafter referred to as "Seller" and PETER M. SURIANO and AMERICAN ALLOY METALS, INC., a Washington corporation formerly known as NICOTI CORPORATION, hereinafter referred to as "Buyer".

The parties hereto agree as follows:

1. PURCHASE AND SALE. Buyer hereby agrees to purchase from Seller and Seller hereby agrees to sell to Buyer the following described personal property:

(a) All inventories of metals and supplies, including back orders of such items, owned by Seller at May 1, 1982. A listing of the inventory of metals on hand at May 1, 1982, and its assigned values is attached as Exhibit "A". It is stipulated that all trade Accounts Receivable, as listed in Exhibit "B", and trade Accounts Payable as listed in Exhibit "C" remain the property and responsibility of the Seller, excepting those as stated in Paragraph 2.

(b) All deferred charges, a book value for which appears in the balance sheet accounts of Seller as of the closing date. In the case of life insurance, such charges and expenses shall include only the portions thereof applicable to the policies listed in Exhibit "D" and less their cash value at the time of closing. Buyer is to obtain liability insurance on the

premises, automobiles, and other coverage as was carried by Seller prior to sale.

(c) All machinery, equipment, automobiles, office furniture and equipment as are included in Exhibit "E" attached hereto and made a part hereof. Seller represents that each of the items of tangible personal property is owned by Seller and

[Page 2]

will be delivered to Buyer at the closing date, whether or not recorded in the balance sheet accounts of Seller as of said closing date.

2. PURCHASE PRICE. The purchase price for the assets shall be in the sum of FOUR MILLION THREE HUNDRED EIGHTY TWO THOUSAND SEVENTY THREE DOLLARS AND 83 CENTS ($4,382,073.83), less THREE HUNDRED EIGHTY TWO THOUSAND SEVENTY THREE DOLLARS and 83 CENTS ($382,073.83), the cumulative balance of the trade payables assumed by the Buyer as listed on Exhibit "F".

3. AUTHORIZATION AND CONSENT. WALTER KILIMNIK warrants and represents to Buyer that he is the owner and holder of all of the issued and outstanding stock of Seller and hereby consents to the sale of the assets of Seller on the terms and conditions set forth herein. Seller agrees to furnish Buyer with a certified copy of a resolution of its Board of Directors authorizing the bulk sale hereunder and attach it to the Bill of Sale.

4. TERMS OF CLOSING. The sale shall be completed on the closing date of May 1, 1982, and title to and possession of the property sold shall pass to the Buyer on that date.

(a) On or before the closing date, Seller shall deliver to Buyer a Bill of Sale in the form attached hereto as Exhibit "G" authorizing delivery of said Bill of Sale upon receipt by Seller of the purchase price provided for in Paragraph 2 above as tentatively computed on the basis of Seller's financial statement as of April 30, 1982, which amount shall be subject to final adjustment as hereinafter provided.

(b) On or before said closing date Buyer shall:

(1) Deliver to Seller the purchase price tentatively computed and comprised of $50,000.00 in cash as Earnest Money, with executed Earnest Money agreement, assumption of certain accounts payable as stated in Exhibit "F", and a promissory note for the balance due, tentatively computed to be $3,950,000.00.

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(c) On or before said closing date, Seller shall:

(1) Upon receipt of purchase price as described in 4(b)(1) above, deliver to Buyer a Bill of Sale and assignments as stated elsewhere herein.

5. CLOSING DATE. Closing date shall be May 1, 1982, unless extended as herein provided. The sale shall be effective as of 8:00 o'clock a.m. of the closing date.

6. DELIVERY OF DOCUMENTS. All documents to which Buyer is entitled hereunder, other than those provided in Paragraph 5, shall be delivered as soon as possible after the closing date, it being the intention of the parties that the delivery of all such documents shall be completed within sixty (60) days after the closing date. Following the closing date Seller will, on request of Buyer,

execute and deliver to Buyer such further instruments in writing as may be required to complete or evidence the transaction herein provided for and Buyer will, on request, execute and deliver like instruments to Seller.

7. ASSIGNMENT OF SELLER'S TRADE OBLIGATIONS. Subject to the closing of the sale as provided herein:

(a) Effective as of the closing date Seller hereby transfers and assigns to Buyer all rights of Seller existing at the date of closing in and under any and all sales orders and sales contracts, purchase orders and purchase contracts, and such other contracts and property as are in process at the time of the closing date, and Buyer hereby assumes and agrees to perform all obligations of Seller thereunder then remaining unperformed except as provided herein.

(b) Notwithstanding the foregoing, if any such contracts are not assignable either by virtue of the provisions thereof or under applicable law, Seller will use its best efforts to obtain the necessary consents thereto and until such consent shall be obtained neither this Agreement nor the Bill of Sale attached hereto as Exhibit "G" shall constitute an assignment thereof. In the event that any purchase order or contract shall not be assignable by Seller, Buyer agrees to purchase

from Seller at the contract price all property thereunder which Seller is obligated to purchase. In the event that any sales order or contract shall not be assignable, Buyer agrees to sell to Seller any products required to complete such contracts at the same price provided for therein.

8. SECURITY AGREEMENT AND COLLATERAL. To the extent Buyer creates accounts receivable from sales made subsequent to closing date, Buyer agrees to allow the accounts receivable as collateral for the payments which are due or to become due under the terms of the promissory note delivered to Seller as part of the purchase price. Buyer also allows his stock certificate in American Alloy Metals, Inc. to be given as collateral for the note. Buyer and Seller agree to the terms of the Working Capital Financial Agreement attached hereto and made a part hereof, designated as Exhibit "H". Balance Sheet of Seller as of April 30, 1982, and Statement of Earnings through April 30, 1982, shall be attached hereto as Exhibit "I".

9. INSURANCE. Seller agrees to keep and maintain casualty and property insurance in force up to and including the closing date hereunder. Buyer agrees to immediately place coverage in amounts sufficient to insure the value stipulated herein and to designate Seller as an additional insured as its interest may appear. Buyer will secure and maintain life insurance on the life of PETER M. SURIANO of the amount of the promissory note balance and with Buyer as sole beneficiary. In this regard, Buyer herewith stipulates and Seller agrees, that in the event of the demise of PETER M. SURIANO, said life insurance is to be used to satisfy the promissory note in full.

10. ADJUSTMENT OF PRICE. Any adjustment of the purchase price shall be accomplished within sixty (60) days after the closing. Any excess price shall be added to the principal of the note or, should the purchase price be adjusted downward, any such amount of difference shall be credited to the unpaid principal balance of the promissory note.

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11. INDEMNIFICATION OF BUYER AND SELLER. Except as otherwise expressly provided herein, Seller and

stockholder indemnify Buyer against and save it harmless from any and all debts, liabilities and obligations of Seller accruing or based upon or arising out of any and all facts occurring before the closing date. Buyer shall indemnify Seller against and save it harmless from any and all debts, liabilities and obligations accruing or based upon or arising out of facts occurring after the closing date and connected with the property and business sold hereunder or the operations thereof. In the case of claims and liabilities under Workers' Compensation and employer liability statutes, where the claim is based upon facts occurring in part before and in part after the closing date, the claim shall be apportioned between the parties as required by law.

Whenever either party shall learn through the filing of a claim or the commencement of a proceeding or otherwise of the existence of any liability for which the other party is or may be responsible under this agreement, such party shall notify the other party promptly and furnish copies of documents and other information as such party may have which may be used or useful in the defense of such claims and shall afford the other party full opportunity to defend the same in the name of any party and shall generally cooperate with the other party in the defense of such claim.

12. WASHINGTON TAXES. Any sales, purchase or use tax under the laws of the State of Washington or of any county or city or subdivision thereof which may be payable by reason of the sale of all or any portion of the property under this Agreement shall be borne by Buyer and Buyer agrees to reimburse Seller with resale certificates applicable to items of tangible personal property which Buyer is purchasing for resale.

13. TRADE NAME - AMERICAN ALLOY METALS, INC. Buyer shall have the right to use the name of American Alloy Metals, Inc., and Seller and stockholder agree that they will not authorize anyone else and to use that name or any names

substantially similar thereto except in the course of winding up the affairs of Seller.

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14. BUSINESS RECORDS. Title to all of Seller's records, documents and papers of every kind and nature pertaining to the business sold hereunder shall remain in Seller, but any thereof which Buyer may reasonably require for use in connection with the operation of said business after the closing date shall be made available to Buyer in such manner as may best meet the respective needs of the parties hereto. In any case the party receiving or retaining such records shall make them available to the other during a three (3) year period following the closing date. After the expiration of said three (3) year period either party shall, before destroying any such records, offer them to the other.

15. CORRESPONDENCE AND MAIL AFTER CLOSING. Buyer shall promptly forward to Seller all correspondence, mail, payments and documents received by Buyer after the date of closing which relate to the operations of the business sold hereunder accruing prior to the closing date. Stockholder or Seller shall promptly forward to Buyer all mail received by them of the type which Buyer is entitled to receive.

16. CONDITION OF PROPERTY. At the time of closing, all property agreed to be sold hereunder shall be delivered to Buyer in the same condition as at the close of business April 30, 1982.

17. NOTICES. All notices required or permitted to be given hereunder shall be in writing and shall be sent first class mail, postage prepaid, deposited in the U.S. Mail in the State of Washington, and if intended for stockholder or Seller shall be addressed to: 6604 N.W.Dogwood Drive, Vancouver, Washington 98663, and if intended for the Buyer shall be addressed to Post

Office Box 1469, Vancouver, Washington 98668. Either party may by written notice to the other change the address for notices sent to it.

18. ASSIGNMENT. Neither this Agreement nor any interest therein shall be assignable by Buyer without prior written consent of Seller. Subject to the preceding sentence, the provisions of this Agreement shall inure to the benefit of and bind the successors and

assigns of Seller and Buyer and the executors, administrators, heirs, successors and assigns of stockholder.

19. WARRANTIES OF SELLER. Buyer has been afforded full opportunity to examine the property to be purchased by it hereunder and no representations or warranties whatever with respect thereto are made by Seller and stockholder or any of them except that:

(a) Seller will have at the closing date and will convey to Buyer good and marketable title to all property agreed to be sold by Seller hereunder free and clear of any lien or encumbrance.

(b) Seller will not be in default on the closing date in any material respect in the performance of any of Seller's obligations under any contract or agreement sold to Buyer hereunder; the contracts and other documents and property agreed to herein are all contracts and documents of the type therein listed; and there are no amendments thereto or modifications thereof except those as understood by both parties.

(c) Seller has obtained, or will before the date of closing obtain, all consents, releases, and permissions of any kind or nature, whether from the public authorities or otherwise, which may be required in connection with the sale of Seller's assets or any part thereof under the provisions of the Agreement.

(d) There are no existing contracts of employment with individual employees of Seller which extend for more than two months.

(e) The property agreed to be sold hereunder includes all improvements and tangible personal property owned by Seller on the closing date except as otherwise expressly provided for herein.

20. AGREEMENT - TERMS. All terms, covenants and conditions of this Agreement are set forth herein and there are no warranties,

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agreements or understandings, express or implied, except such as are expressly set forth herein.

21. GOVERNING LAW. This Agreement is to be governed by and construed under the laws of the State of Washington.

22. NONCOMPETITION AGREEMENT. WALTER KILIMNIK, sole stockholder of Seller, in consideration of Buyer's agreement to purchase assets of Seller as herein stated, agrees to refrain from carrying on a similar business to that sold hereunder, with the exception of Lommus Corporation, a Washington corporation already in operation, for a period of three (3) years from date of the transfer of possession hereunder. For the purpose of this

paragraph, a business shall be deemed carried on by WALTER KILIMNIK if carried on by a partnership of which he is a general or limited partner, or a corporation or association of which he is a shareholder or member. In the event that WALTER KILIMNIK carries on a business in contravention of this paragraph, Buyer may suspend his monthly payments on the promissory note for the purchase of the assets attached hereto and incorporated herein by reference. The suspension of payments shall last for so long as WALTER KILIMNIK remains in a competitive business. Upon termination of the competitive business, the regular monthly payments on the note shall continue on their regular schedule, but all payment rights during the period of competition shall be forfeited and deemed credited on the Promissory Note by Seller, its agents or assigns.

23. PREMISES LEASE. Seller hereby represents and warrants to Buyer that Seller will secure Lessor's written consent to renegotiate that certain lease made July 25, 1980, between WALTER and KATHLEEN KILIMNIK and AMERICAN ALLOY METALS, INC., now WNK ENTERPRISES, INC., and that he will obtain a reasonably similar lease for Buyer.

24. BUYER'S AUTHORIZATION FOR PURCHASE. Buyer agrees to furnish Seller with a certified copy of a resolution of its Board of Directors authorizing the purchase hereunder and attach it to Seller's copy of this Agreement.

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25. UCC-1 FOR SALE. Buyer agrees to execute a Form UCC-1 and to initial such additional sheets as may be required to describe the items of personal property being purchased hereunder. Seller shall be under no obligation to file same in the Office of Secretary of State of Washington, nor shall Seller be obliged to publish a Notice of Sale as may be required under the Bulk Sale Law of the State of Washington. Should any

governmental agency, entity or trade creditor make any claim against Buyer for which he has not received credit against the purchase price as hereinbefore defined, Seller shall be notified of said claim and have a reasonable time within which to resolve the same. Should Seller fail to obtain the resolution and discharge of such claim, Buyer may reduce the next installment payment due Seller under the terms of the note hereinbefore referred to by the amount thereof.

26. ADJUSTMENT OF PRICE - DOCUMENTATION OF INTENT. Any adjustment in the purchase price shall be reflected by endorsement on the promissory note; however, such endorsement shall not increase a monthly payment of interest and principal required pursuant to the terms of said promissory note.

IN WITNESS WHEREOF, we have hereunto set our hands this 1 day of May, 1982.

AMERICAN ALLOY METALS, INC.
formerly known as
NICOTI CORPORATION

By /signed/
Authorized Officer/Buyer

WNK ENTERPRISES, INC.
formerly known as
AMERICAN ALLOY METALS, INC.

By /signed/
Authorized Officer/Seller

APPENDIX 13

UCC-1 Financing Statement of Walter Kilimnik/WNK Enterprises, Inc. re: American Alloy Metals, Inc.

1. DEBTOR(S) (or assignor(s)): (last name first, and address(es))

American Alloy Metals, Inc.
Post Office Box 1469
Vancouver, WA 98668

* * *

3. SECURED PARTY(IES) (or assignee(s)) (name and address):

Walter Kilimnik
WNK Enterprises, Inc.
6604 N. W. Dogwood Drive
Vancouver, WA 98663

* * *

7. This FINANCING STATEMENT covers the following types or items of property:

All inventory, receivables, equipment, and all proceeds from the sale thereof, as well as all after-acquired inventory, receivables and equipment purchases from April 30, 1982.

8. RETURN ACKNOWLEDGEMENT COPY TO:

Walter Kilimnik
6604 N. W. Dogwood Drive
Vancouver, WA 98668

* * *

/signed/
TYPE NAME(S) OF DEBTOR(S) (or assignor(s))

American Alloy Metals, Inc.
Peter M. Suriano, Treasurer
SIGNATURE(S) OF DEBTOR(S) (or assignor(s))

APPENDIX 14

Working Capital Financial Agreement between Walter Kilimnik and Peter Suriano/American Alloy Metals, Inc., dated May 1982.

THIS AGREEMENT between WALTER KILIMNIK, individually, his estate, heirs and assigns, hereinafter called "Kilimnik", and AMERICAN ALLOY METALS, INC., a Washington corporation, and PETER M. SURIANO, individually, hereinafter called "American" and/or "Suriano", hereby agree to the terms of this document for the purpose of providing working capital funds to American.

W I T N E S S E T H:

1. On or about May 1, 1982, Kilimnik directed his wholly owned corporation, WNK ENTERPRISES, INC., to sell all of its operating inventory, supplies and equipment to American under and Agreement for Sale of Assets, attached hereto and herein incorporated by this reference, for a purchase price of Four Million Three Hundred Eighty Two Thousand Seventy Three and 83/100 Dollars ($4,382,073.83), less Three Hundred Eighty Two Thousand Seventy Three and 83/100 Dollars ($382,073.83), the cumulative balance of the trade payables assumed by Suriano as listed on Exhibit F to the Agreement for Sale of Assets.

2. The terms of the transaction basically provide for a down payment by American of Fifty Thousand and No/100 Dollars ($50,000.00) with the balance due on a promissory note which provides for level payments of Seventy Five Thousand and No/100 Dollars ($75,000.00) per month until the entire principal balance is paid.

3. The assets acquired by American and Suriano include inventory, supplies and equipment to carry on the business of trading in high-technology metals, but that the business does not have sources of operating cash needed to finance the day-to-day affairs of the business.

4. The business of American may fail in the absence of such working capital.

[Page 2]

NOW, THEREFORE, in consideration of the above premises and other conditions and considerations as listed below it is therefore agreed as follows:

1. Kilimnik will provide a line of credit for American and Suriano by advancing them funds up to Two Hundred Fifty Thousand and No/100 Dollars ($250,000.00) in cash from time to time. Kilimnik will continue to keep this line of credit open to American and Suriano for a period of three (3) years from the closing date of the sale of the assets from his corporation to American.

2. American will execute in Kilimnik's behalf an Optional Advance Note, attached hereto and incorporated by this reference, for the sum of Two Hundred Fifty Thousand and No/100 Dollars ($250,000.00) plus provide a Security Agreement, attached hereto and incorporated by this reference, suitable to Kilimnik and providing for security coverage under the rules as prescribed in Article 9 of the Uniform Commercial Code.

3. The interest charged on the Optional Advance Note shall be an equivalent rate to that charged by the Columbia Daily Income Company, or its successors on the first business day of each month. Interest shall be payable monthly.

4. The demand for funds from Kilimnik by American shall be made solely by Suriano, in writing, at Kilimnik's last known address. Suriano is the only authorized agent of American to authorize such funds, other than in the absence of an agreement by all parties to the contrary, and the funds shall be deposited with the corporation in such manner and under such terms as Suriano directs in his writings.

5. If a demand for funds is made by American upon the request of Suriano and Kilimnik does not provide the requested funds within forty-eight (48) hours, American and/or Suriano may withhold making the regular monthly payments for the promissory note included within the Agreement for Sale of Assets. The amounts withheld, however, shall not exceed the difference

[Page 3]

between the sum of the outstanding principal balance of the Optional Advance Note and $250,000.00.

6. No rights may be assigned under this Agreement without the written consent of all parties.

7. This contract shall be binding upon and inure to the benefit of the parties, their heirs, personal representatives, legal representatives, successors and assigns.

8. In the event suit or action is instituted to enforce any of the terms of this Agreement, the prevailing party shall be entitled to recover from the other party such sums as the court or courts may adjudge reasonable as attorney's fees at the trial or upon appeal of the suit or action, in addition to all other sums provided by law.

8. This Agreement is the entire, final and complete agreement of the parties pertaining to the working capital financing

of the parties and supersedes and replaces all written and oral agreements made or existing between the parties or their representatives insofar as the working capital arrangements of American Alloy Metals, Inc. is concerned. This Agreement may not be modified orally, but only upon a subsequent agreement in writing signed by the parties to be charged.

IN WITNESS WHEREOF, the parties have executed this Agreement effective this _____ day of May, 1982.

WALTER KILIMNIK,
Individually

_____/signed/_____

WNK ENTERPRISES, INC.

By_____/signed/_____
Walter Kilimnik,
President

PETER M. SURIANO
Individually

_____/signed/_____

AMERICAN ALLOY METALS, INC.

By_____/signed/_____
Peter M. Suriano,
Treasurer

APPENDIX 15

Security Agreement
between Walter Kilimnik and
Peter Suriano/American Alloy Metals, Inc.
dated May, 1982.

In consideration of an extension of credit by WALTER KILIMNIK, a Washington resident, his estate, heirs, assigns or agents, (Secured Party, hereinafter called "Kilimnik"), to AMERICAN ALLOY METALS, INC., a Washington corporation (hereinafter called "Debtor"), and as security for payment of all sums due or to become due or owing by Debtor to Kilimnik for the unpaid principal and interest on an Optional Advance Note dated May 1, 1982, Debtor hereby grants, transfers and assigns to Kilimnik a lien upon and security interest in the following property (hereinafter called "Collateral"):

1. In all of Debtor's accounts, chattel paper, documents, instruments and general intangibles, now existing or hereafter arising, and in all proceeds thereof; and

2. In all of Debtor's inventory, including raw materials, work in process and material used or consumed in Debtor's business, either now or hereafter acquired, including merchandise and stock in trade, either in possession of the Debtor, warehouseman, bailee or any person and all products thereof, and all proceeds thereof.

It is further agreed as follows:

1. That Debtor will perform all of its obligations under this Security Agreement and under all agreements and instruments of indebtedness secured hereunder.

2. That the Collateral will be located at the offices of the Debtor in Vancouver, Washington.

[Page 2]

3. That Kilimnik may prepare, execute and file or record financing statements, continuation statements, amendments, termination statements, application for registration and like papers to perfect, protect, preserve or release the rights evidenced by this Security Agreement.

4. That Debtor will pay all costs and expenses, including reasonable attorney's fees, whether or not suit is filed, and any attorney's fees and costs on appeal, and any expenses of title search, filing and recording incurred by Kilimnik in the preservation, realization, enforcement and exercise of the rights, powers, remedies and Collateral of Kilimnik.

5. That Kilimnik does not assume and shall not be subject to any obligation or liability to any third parties in connection with any of the personal property of Debtor in which a security interest is granted, transferred or assigned to Kilimnik hereunder.

6. That Debtor will keep the Collateral in good condition, reasonable wear and tear excepted, and will permit Kilimnik to inspect the Collateral at any time.

7. That Debtor agrees to deliver copies of all records concerning said Collateral to Kilimnik at Kilimnik's request. Kilimnik shall have the right at all reasonable times and upon reasonable notice, to inspect all records of Debtor concerning said Collateral and Debtor's performance hereunder.

8. That Debtor will insure the Collateral against hazards. If Debtor fails to obtain such insurance, Kilimnik shall

have the right, but not the obligation, to obtain insurance at Debtor's expense.

[Page 3]

9. That Debtor will defend the Collateral against the claims and demands of all persons and will pay before delinquency any tax or other governmental charge which is or can become, through assessment or distraint or otherwise, a lien or charge upon any of said Collateral, and will pay any tax which may be levied on any obligation secured hereby.

10. That Kilimnik is not required to, but may at his option, pay any tax or other charge payable by Debtor, and any amount so paid with interest thereon at the rate provided for in the above indebtedness, or, at the rate of 10% per annum whichever is greater, from the date of payment until repaid shall be secured hereby and shall be repayable by Debtor on demand.

11. That this Security Agreement shall not be qualified or supplemented by course of dealing. No waiver or modification by Kilimnik of any of the terms and conditions hereof shall be effective unless in writing signed by him.

12. That the following shall be events of default hereunder:

Failure of Debtor to pay any debts secured hereby or incurred hereunder when due; failure of Debtor to perform any obligations secured hereby or incurred hereunder when the same should be performed; breach by Debtor of a promise, covenant, or warranty contained herein; filing of a petition by or against Debtor under the bankruptcy or like law; receivership or assignment for the benefit of creditors of Debtor; levy by any legal process upon any of the property of Debtor or of any of the Collateral; insolvency or cessation of the business of Debtor; or the occurrence of any sale of

all or a substantial part of the assets of Debtor, other than in the ordinary course of business.

[Page 4]

13. That upon the occurrence of any default, Kilimnik shall have the right to declare immediately due and payable all or any indebtedness secured hereby and to terminate any commitments to make any loans or otherwise extend credit to the Debtor; Kilimnik shall have all other rights, privileges, powers and remedies provided by the law and this agreement, including those remedies provided by Article 9 of the Uniform Commercial Code.

14. That each demand, notice or other communication shall be served or given by mail or telegraph addressed to the party at his address set forth herein or as changed by written notice to the other party, or by personal service upon the party or proper officer. Reasonable notice, when notice is required, shall be deemed to be ten (10) days.

15. That all the terms herein and the rights, duties and remedies of the parties shall be governed by the law of the State of Washington.

IN WITNESS WHEREOF, the parties have executed this Agreement this 1 day of May, 1982.

Debtor's Address:
P.O. Box 1469
Vancouver, Washington 98668

AMERICAN ALLOY
METALS, INC.

By /s/
Peter M. Suriano,
Treasurer

Walter Kilimnik's
Address:
6604 N.W. Dogwood Drive
Vancouver, Washington 98663

APPENDIX 16

United States Bankruptcy Court,
Western District of Washington at Tacoma

In re: AMERICAN ALLOY METALS, INC.; No. 85-02660T;
WHITESIDES [now STOUMBOS] v. WALTER KILIMNIK, et al.
Adv. No. 86-30806T

Affidavit of Walter Kilimnik in Opposition to Trustee's Motion for Partial Summary Judgment and Preliminary Injunction, and Supporting Defendant's Cross Motion for Partial Summary Judgment

May 1, 1986.

STATE OF WASHINGTON)
: ss.
County of Clark)

WALTER KILIMNIK, having been duly sworn on oath, deposes and says:

I. HISTORY

1. I am the former owner, officer and director of the debtor. I have first-hand knowledge of all facts in this affidavit.

2. I have been involved in the metal alloy business for more than twenty (20) years.

3. In July, 1965, I formed a California corporation, American Alloy Metals, Inc., which carried on a metal alloy wholesale business.

I was the sole shareholder.

4. In January, 1979, after building my California company into a thriving business, I expanded by forming a second metal alloy wholesale company, American Alloy Metals, Inc. in Nevada. I was the sole shareholder of this company as well.

5. Business continued to flourish, and in February, 1980, I merged my California and Nevada corporations to form American Alloy Metals, Inc., a Washington corporation with its principal place of business in Vancouver, Washington. I remained the sole shareholder.

6. At the time I formed American Alloy Metals, Inc of Washington, until July 1, 1981, Peter Suriano, a C.P.A. with Price Waterhouse, provided professional accounting and tax services to my company. On July 1, 1981, Mr. Suriano left Price Waterhouse and came to work for American Alloy Metals, Inc. as General Manager.

II. SECURED SALE OF AMERICAN ALLOY METALS, INC.

7. In the early winter of 1981, I had discussions with Peter Suriano about selling American Alloy Metals, Inc. to him since I was ready to think about relinquishing control of the company and retire.

8. Pursuant to a Purchase and Sale Agreement reached, I terminated American Alloy Metals, Inc. forming WNK Enterprises, Inc. in its place. As evidenced by the Purchase and Sale Agreement and Promissory Notice, copies of which are attached hereto as Exhibit A and B and incorporated herein, on May 1, 1982, WNK Enterprises then sold to a corporation formed by Peter Suriano the inventory, equipment, trade name and other assets of the former American Alloy Metals, Inc.

9. As the Purchase and Sale Agreement provides, the terms of

the purchase included a "down payment" of $50,000.00 in cash and assumption of certain accounts payable. The balance of the purchase price was evidenced by a promissory note payable to WNK Enterprises for $3,950,000.00, from Mr. Suriano and the new American Alloy Enterprises, Inc.

10. To safeguard for me the fruits of a business I had spent almost twenty (20) years' building, and to compensate me for the risk that Mr. Suriano, a relative newcomer to the metal alloy business would not run the business as ably as I had, it was my intent to fully secure the sum due under the promissory note. This intent is reflected in both the Purchase and Sale Agreement and Promissory Note.

11. As a further reflection of our intent and to perfect the security agreement, on October 6, 1982, I filed with the Washington Secretary of State a UCC-1 financing statement. A true copy of the financing statement is attached hereto as Exhibit C and incorporated herein.

12. The Purchase and Sale Agreement, Promissory Note and financing statement, when read together, as they are so intended to be read, show that the balance due from the sale of American Alloy Metals, Inc. was secured by all inventory, receivables and equipment of the company, as well as proceeds therefrom plus inventory, receivables and equipment purchased subsequent to April 30, 1984 (the date of sale). The Purchase and Sale Agreement and Promissory Note were further secured by a possessory security interest in the stock certificates by me.

13. On October 1, 1982, WNK Enterprises, Inc. assigned to me WNK's interest in the above-referenced promissory note and security

agreement. A true copy of the assignment is attached hereto as Exhibit D and incorporated herein.

14. Subsequent to the May 1, 1982 sale of American Alloy Metals, Inc. to Peter Suriano, I no longer had control over the company. I was employed by American Alloy Metals, Inc. as a consultant and was also a director. I had no stock, however, and had no say over the daily operations of the company.

15. The sale of the assets of WNK Enterprises, Inc. to the new American Alloy Metals, Inc. was a valid and good faith arms' length transaction. Both Mr. Suriano and I had our own independent legal counsel advise us during the negotiation and execution of the sales documents.

III. PURCHASER'S DEFAULT

16. Unfortunately American Alloy Metals, Inc. under Mr. Suriano did not prosper. Payments due to me under the promissory note from American Alloy Metals, Inc. had been irregular at best and then finally in late winter 1985 ceased. I attempted to negotiate with Mr. Suriano about resuming future installments, but we were unable to reach an agreement.

17. In March 1985, I served Mr. Suriano with a Notice of Default under the Promissory Note.

18. Subsequent to serving that notice, my employment as a consultant with American Alloy Metals, Inc. was terminated.

19. My attorneys tried to work out an arrangement with Mr. Suriano's attorneys to cure the default but to no avail.

[Page 5]

IV. REINVOLVEMENT WITH CONTROL OF COMPANY

20. I felt that if I returned to managing American Alloy Metals, Inc., I might be able to resurrect the company Mr. Suriano had mismanaged. So to that end I agreed with Mr. Suriano to pay him for a proxy to vote his sole shareholder stock in American Alloy Metals, Inc.

21. On May 6, 1985, I started to become actively involved with American Alloy Metals, Inc. for the first time since selling my company to Mr. Suriano in May, 1982.

22. It took me quite a while to familiarize myself with the company's operations since Mr. Suriano had made some significant changes after taking control in May, 1982.

23. By July, 1985, I felt I had a grasp of American Alloy Metals, Inc.'s situation. But shortly thereafter, and to a large extent because of finally seeing the true picture, I suffered a major heart attack. I thus had to be in the intensive care unit for two weeks, with repeated visits to the hospital through July, August and September, 1985.

24. Despite exercising some influence at American Alloy Metals, Inc. in reality from May through September, 1985, I still was not running the company.

V. REALIZING ON SECURITY

25. By September 13, 1985, I came to the heartbreaking conclusion that American Alloy Metals, Inc. could not be

rehabilitated due to cash flow problems created by a large number of accounts payable. I felt I had no choice but to file suit in Clark County Superior Court for the default in payments under the promissory note.

[Page 6]

26. To protect what I could of my investment on October 2, 1985, I exercised my rights under RCW 62A.9-505 and recovered from American Alloy Metals, Inc. inventory, equipment and accounts receivables covered by the security agreements.

27. I had previously learned that the only perfected secured creditor of American Alloy Metals, Inc. other than me was Mitsui and Company and I did not realize upon assets which Mitsui had superior perfection. A true copy of the UCC-11R showing perfected creditors of American Alloy Metals, Inc. is attached hereto as Exhibit E and incorporated herein.

28. At no time have I seized from American Alloy Metals, Inc. any goodwill, or other items that could be characterized as having going-concern value. Indeed, I gave specific notice to customers of American Alloy Metals, Inc. who owed money to the company that such money should be paid to me by virtue of my security agreement with American Alloy Metals, Inc. and did not in any claim I was carrying on the business of American Alloy Metals, Inc. A true copy of the Notice sent to customers of American Alloy Metals, Inc. is attached hereto as Exhibit F and incorporated herein.

29. I recovered the assets of American Alloy Metals, Inc. in full satisfaction of the obligation due to me under the Promissory Note. In return American Alloy Metals, Inc. waived its right to object to my taking the assets. A true copy of the Statement Waiving Rights which I received is attached hereto as Exhibit G and incorporated herein.

VI. CURRENT STATUS

30. To my knowledge, American Alloy Metals, Inc. is no longer

doing any business.

31. I am again working in the metal alloy wholesale business. My company is Aerospace and Corrosion International, Inc. I am carrying on this business in my own right and am not utilizing any good will or going-concern value of American Alloy Metals, Inc.

32. Aerospace and Corrosion International, Inc. is a commercial competitor of Cabot Corporation. It is my understanding Cabot Corporation has lost market share and is also losing money in part because of competition from my new company. Two former key West Coast employees of Cabot Corporation work for my company. Further, my company is currently representing other producers of alloys, which allow Aerospace and Corrosion International, Inc. to undersell Cabot.

33. It is my opinion that Cabot Corporation filed an involuntary petition against American Alloy Metals, Inc. and also is paying for the Trustee's attorney (who was also Cabot's attorney) to bring the instant adversary proceeding against me and my new company to harass me, intimidate me, and to attempt to financially neutralize me as a competitor.

/signed/
Walter Kilimnik

Signed and sworn to before me this 1st day of May, 1986.

/s/
Notary Public for Washington
My appointment expires: 2.19.89

APPENDIX 17

United States Bankruptcy Court,
Western District of Washington at Tacoma

In re: AMERICAN ALLOY METALS, INC.; No. 85-02660T;
WHITESIDES [now STOUMBOS] v. WALTER KILIMNIK, et al.
Adv. No. 86-30806T

Affidavit of Peter M. Suriano in Opposition to Trustee's Motion for Partial Summary Judgment and Preliminary Injunction, and Supporting Defendants' Cross Motion for Partial Summary Judgment

May 1, 1986

STATE OF WASHINGTON)
: ss.
County of Clark)

PETER M. SURIANO, having been duly sworn on oath, deposes and says:

I. HISTORY

1. I am the owner of the outstanding stock of American Alloy Metals, Inc., debtor. I have first-hand knowledge of all facts in this affidavit.

2. From July, 1979 to July 1, 1981, I was employed as a Certified Public Accountant with Price Waterhouse. During the period of time, as a C.P.A. with Price Waterhouse, I provided professional

accounting services and tax advice to American Alloy Metals, Inc., owned by Walter Kilimnik.

3. I was very impressed with Mr. Kilimnik's company, and on July 1, 1981, I left Price Waterhouse to become the general manager of American Alloy Metals, Inc.

4. I continued to be impressed with American Alloy Metals, Inc. and therefore decided to purchase the company from Walter Kilimnik.

II. SECURED SALE OF AMERICAN ALLOY METALS, INC.

5. Pursuant to an agreement reached with Mr. Kilimnik to effectuate the sale of the company to me, in December, 1981, I formed Nicoti Corporation. After Walter Kilimnik dissolved American Alloy Metals, Inc. and formed WNK Enterprises, Inc. in its place, I changed the name of Nicoti Corporation to the new American Alloy Metals, Inc. I was the sole shareholder of this company.

6. On May 1, 1982, I executed sales documents on behalf of myself and the new American Alloy Metals, Inc. for the

PMS

purpose of the inventory, equipment, ~~accounts receivable~~ and trade name of WNK Enterprises, Inc. formerly American Alloy Metals, Inc. In consideration for the sale, I paid $50,000.00 down and made a promissory note in the amount of $3,900,000.00 from the new American Alloy Metals, Inc. and from me to WNK Enterprises, Inc. The note provided for monthly installments of $75,000.00 until satisfied.

7. In recognition of the fact that I was a relative newcomer to the metal alloy business and that by turning the company over to me, Mr. Kilimnik was putting at risk an investment he spent almost twenty (20) years building, I agreed the promissory note should be secured. This

intent is reflected in both the Purchase and Sale Agreement and Promissory Note, true copies of which are attached hereto as Exhibits A and B and incorporated herein.

8. To further reflect our intent to secure the balance of the purchase price and to perfect the security agreement, I executed a UCC-1 financing statement, which I understand Mr. Kilimnik filed with the Washington Secretary of State on October 6, 1982. Attached hereto as Exhibit C and incorporated herein is a true copy of the financing statement which was provided to me.

9. The Purchase and Sale Agreement, Promissory Note, and Financing Statement, when read together as they are so intended to be read, show that the balance due from the sale of American Alloy Metals, Inc. was secured by all inventory, receivables and equipment of the company, as well as proceeds therefrom plus after acquired inventory, receivables and equipment. The Purchase and Sale Agreement and Promissory Note were further secured by a possessory security interest in my stock certificates by Mr. Kilimnik.

10. The sale of the assets of WNK Enterprises, Inc. to the new American Alloy Metals, Inc. and to me was a valid and good faith arms' length transaction. My legal counsel advised me during the negotiation and execution of the sales documents, and Mr. Kilimnik had his own independent legal counsel do the same.

III. KILIMNIK'S INVOLVEMENT WITH MY CORPORATION

11. When I originally incorporated the new American Alloy Metals, Inc. in early 1982, Walter Kilimnik was named as President, and I was Secretary/Treasurer. Additionally, Mr. Kilimnik was hired by the

company in a consulting capacity in recognition of his superior knowledge of the metal alloy business. A true copy of his employment agreement is attached hereto as Exhibit D and incorporated herein. As specified in the agreement, Mr. Kilimnik's duties consisted of advising and counseling me on business and financial planning for the corporation.

12. From the inception of the new American Alloy Metals, Inc. in May 1982 until May 6, 1985, I was the chief executive officer of the corporation and had ultimate authority for all corporate decisions.

13. As chief executive officer during that time period, I was directly involved with ordering inventory, payment of the corporation's obligations, and generally in charge of the daily management and control of the corporation.

IV. PURCHASER'S DEFAULT

14. American Alloy Metals, Inc. made payments under the promissory note to Walter Kilimnik (who pursuant to assignment dated October 1, 1982 took WNK Enterprises, Inc.'s interest in the promissory note and security agreement) on May 21, 1982, July 31, 1982, August 31, 1982 and September 30, 1982. Unfortunately, the company did not prosper and no further installment payments were made.

15. In the late winter of 1984, I met with Mr. Kilimnik to discuss making up the delinquent payments and resuming future payments. We were unable to come to mutually satisfactory arrangements.

16. Therefore in March, 1985, I was served with a Notice of Default for failure to make payments under the terms of the promissory note.

[Page 5]

17. After receiving the notice, I consulted with legal counsel and was advised to terminate Walter Kilimnik's employment with American Alloy Metals, Inc. A true copy of the letter sent to Mr. Kilimnik so informing him that his employment was terminated is attached hereto as Exhibit E and incorporated herein.

18. For several weeks my attorneys negotiated with Mr. Kilimnik's attorney's concerning Mr. Kilimnik's claim for the past due promissory note payments. Finally it became obvious that neither the corporation nor I would be able to make up the past due payments and continue with future installments. I decided it would be in the best interests of everyone concerned if I were to relinquish some control and management of American Alloy Metals, Inc.

19. Out of these negotiations in the spring of 1985, I acquired the understanding that Mr. Kilimnik desired to again become actively involved in the daily management of American Alloy Metals, Inc. in an attempt to salvage the company he had built up for almost twenty (20) years. To that end, I entered into an agreement with Mr. Kilimnik whereby I gave him my proxy to vote all my sole ownership stock in American Alloy Metals, Inc. and in return I received payment for my proxy. This agreement was executed on May 6, 1985.

20. Upon execution of the proxy agreement, I ceased being involved with the day-to-day control and management of American Alloy Metals, Inc.

21. American Alloy Metals, Inc. is no longer doing any business.

/signed/
Peter M. Suriano

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Signed and sworn to before me this 1st day of May, 1986.

/signed/
Notary Public for Washington
My appointment expires:
2/14/89